Taxable Fringe Benefit Guide

TRAINING PROVIDED
BY
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PART I - TRAVEL RELATED ISSUES

PART II - NON-TRAVEL RELATED ISSUES

COMPLIANCE: TAXABLE FRINGE BENEFITS

Course Description: This class given by the Internal Revenue Service provides understanding on which employee fringe benefits related to travel and non-travel issues are taxable and reportable under the Internal Revenue Code, regulations, and procedures.

Target Group: All personnel who need to determine the taxability, withholding, and reporting requirements regarding employee fringe benefits.

Course Objectives: At the conclusion of this course, participants should:

- Know which travel and non-travel related fringe benefits commonly provided by employers are taxable and which taxes must be withheld from employees' payroll,
- Have a general understanding how to compute the taxable value for those taxable fringe benefits discussed,
- Know how to report the taxable value on Forms W-2 and 1099-MISC,
- Know the additional federal reporting requirements that are in effect for certain fringe benefits, and
- How to obtain answers from the Internal Revenue Service to questions throughout the year regarding taxation and reporting requirements.

NOTICE

This guide is intended to provide basic information on the subjects covered. It was not possible to include complete details on each individual topic. It is intended to serve as a resource guide and not as a legal reference. Additional research may be required before a determination may be made on a particular issue. For that purpose, references and citations are included in each chapter.

This text is not an officially approved document of the Internal Revenue Service.

FRINGE BENEFITS

General Information

What is a Fringe Benefit?

IRC § 61(a)(1)
Pub. 15-B

A form of pay for the performance of services (includes property, services, cash or cash equivalent). Applies to services of employees and independent contractors. Unless otherwise indicated, this guide applies to fringe benefits provided by an employer to an employee.

Taxability of Fringe Benefits

Fringe benefits for employees are taxable wages unless specifically excluded by a section of the Internal Revenue Code (IRC).

IRC § 61
IRC § 3121, 3401

More than one Internal Revenue Code Section may apply to the same benefit :

Example: Education expenses up to $5,250 can be excluded from tax under IRC §127. Amounts over $5,250 may be excluded from tax under IRC §132.

Taxable to an employee even if the benefit is received by/for another, e.g. a spouse, a child.

Reg. § 1.61-21(a)(4)

Taxable means included in the employees' wages and reported on Form W-2, subject to federal income tax withholding, social security (6.2%) and Medicare (1.45%), unless the employee has already reached the current calendar year's maximum social security tax limits. An employer's matching contribution is required for social security and Medicare (7.65%).

If an employee's wages are not normally subject to social security or Medicare taxes, any taxable fringe benefits would also not be subject to social security or Medicare taxes.

Section 218 of the Social Security Act

Exceptions: Certain deferred compensation plans, such as IRC §457 and §403(b) plans, may be subject to social security and Medicare taxes but *not* to federal income tax (FIT).

FRINGE BENEFITS

Valuing Taxable Fringe Benefits

General Rule - Fair Market Value (FMV) Reg. §1.61-21(b)

Taxable fringe benefits are valued at the Fair Market Value (FMV).

FMV- The amount an individual would have to pay a third party to buy or lease the benefit. Often, the cost and FMV are the same.

Valuation - FMV of taxable benefit less any amount paid by or for the employee

Example: An employee has a taxable fringe benefit of $3.00 per day for personal use of the employer's vehicle. The employer has the option of including the $3.00 per day in the employee's wages or the employee may pay the employer the $3.00 per day and -$0- is included in the employee's wages.

Special valuation rules apply for certain fringe benefits and will be covered in other chapters.

Types of Fringe Benefits

Taxable, Non-taxable, Partially-taxable, Tax-deferred

Taxable – includible in gross income unless excluded under an IRC section. If the recipient is an employee, includible as a wage. Reg. § 1.61-21(a)

Example: Bonuses are always taxable because no IRC section excludes them from taxation.

Non- taxable – excluded from wages by a specific IRC section

Example: Medical care premiums paid by an employer are not taxable wages to employees because IRC §106 excludes them.

Partially taxable - Part is excluded by IRC section and part is taxable Reg. §1.132-6(d)(1)

Example: Benefits with dollar limitations are not taxable up to certain dollar limits, e.g. public transportation subsidy or parking.

Deferred taxation – Employer's contributions to an employee's pension plan may not be taxable when made, but retirement distributions may be taxed when made to the employee. IRC 402(a)

FRINGE BENEFITS

Examples of IRC Sections That Exclude Fringe Benefits From Wages

- **IRC §117(d) - Qualified tuition reductions**
- **IRC §119 - Meals or lodging for employer's convenience**
- **IRC §125 - Cafeteria plans**
- **IRC§ 127 - Educational assistance program**
- **IRC §129 - Dependent care assistance program**
- **IRC §132 - Certain fringe benefits**

IRC §132 - Non-Taxable Fringe Benefits

IRC §132 excludes certain fringe benefits from taxation. IRC§ 132 may be used only if the taxability of a particular benefit (other than de minimis fringe) is not covered by another Code section. If non-taxable, the benefit is excludable from wages.

Categories Of Non-Taxable (Excludable) Fringe Benefits:

- **No Additional-Cost Service:** IRC §132(b)
  Example: Free passes for airline employees

- **Qualified* Employee Discounts:** IRC §132(c)
  Example: Discounts for department store employees

- **Working Condition Fringe:** IRC §132(d)
  Example: Business use of employer-provided automobile

- **De minimis Fringe:** IRC §132(e)
  Example: Benefit too small to keep record of and infrequent

- **Qualified* Transportation Expenses:** IRC §132(f)
  Example: Transit passes

- **Qualified* Moving Expense Reimbursements** IRC §132(g)

- **Qualified* Retirement Planning Services** IRC §132(m)

*"Qualified" means that the rules in the Code sections are being followed. (i.e., if rules for moving expenses are met, then they are "qualified" moving expenses.)

FRINGE BENEFITS

Working Condition Fringe Benefits

Definition IRC § 132(d)

Property or service provided by an employer to an employee that if the employee had paid for it, he/she could have deducted the cost as a business or depreciation expense on Form 1040. Therefore, if the cost of an item is deductible by an employee as a business expense, it may be excludable from the employee's wages if provided by the employer.

General Rules for Working Condition Fringe Benefits

- Benefit must relate to employer's business
- Employee would have been entitled to a 1040 deduction
- Business use must be substantiated with records
- **Certain benefits have other specific requirements**
  Example: Employer-provided vehicles

Definition of Employee <u>for Working Condition Fringe Benefits</u>

Current employees Reg. §1.132-1(b)(2)
Partners
Directors of employer
Independent contractors
Volunteers Reg. §1.132-5(r)(4)

Although not employees for employment tax purposes, independent contractors are eligible to receive nontaxable reimbursements as working condition fringe benefits because they are treated as employees for this purpose.

⇨ **Note**: Taxable fringe benefits for employees are reportable on Forms W-2/W-3. Taxable fringe benefits for independent contractors are reportable on Form 1099.

Benefits <u>Not</u> Qualifying as Working Condition Benefits

Cash payments/Cash equivalents
- unless paid under an accountable plan

Physical examinations (may be excludable under IRC §105)
Club dues

FRINGE BENEFITS

De Minimis Fringe Benefits

Definition

Property or service provided by an employer for an employee that has a small value and accounting for it is unreasonable or administratively impractical. The value of the benefit is determined by the frequency provided to each individual employee or if this is not administratively practical, by the frequency provided to the whole workforce. IRC § 132(e)

Example: An employer gives employees snacks each day valued at 75 cents. Even though small in amount, the benefit is provided on a regular basis and is, therefore, taxable as a wage.

The IRS has given advice at least once that a benefit of $100 did not qualify as de minimis. ILM 200108042

Examples of Excludable De Minimis Fringe Benefits: Reg. §1.132-6(e)(1)

Occasional (infrequent) <u>not routine</u>:

- Personal use of photocopier (with restrictions)
- Group meals, employee picnics
- Theater or sporting event tickets
- Coffee, doughnuts, and/or soft drinks
- Flowers, fruit for special circumstances
- Local telephone calls
- Traditional birthday or holiday gifts (not cash) with a low FMV
- *"Restricted" gift certificates limited to specific non-cash items, e.g. holiday turkey, coffee drinks
- Commuting use of employer's car if no more than once per month Reg. §1.132-6(d)(3)

Benefits <u>Not</u> Qualifying as De Minimis Fringe Benefits

- Cash - except for occasional and infrequent meal money to allow overtime work
- *Cash equivalent (i.e., savings bond, gift certificate for department store or allowing "cash back")
- Certain transportation fares
- Use of employer's apartment, vacation home, boat
- Commuting use of employer's vehicle more than once a month Reg. §1.132-6(d)(3)

* American Airlines, Inc, v. United States, 40 Fed. Cl. 712(1998)

FRINGE BENEFITS

De Minimis Fringe Benefits - cont.

Definition of Employee for De Minimis Fringe Benefits Reg. §1.132-1(b)(4)

Any recipient of a de minimis fringe benefit

Cliff Provision Reg. §1.132-6(d)(4)

If a benefit does not qualify as de minimis fringe benefit, the entire benefit is taxable, not just the portion that exceeds the de minimis limits.

Special Accounting Rules

IRS Ann. 85-113, 1985-31 provides special rules for reporting taxable fringe benefits.

Timing of Taxability - Calendar year basis IRC 451(a)

Generally, taxable fringe benefits are included in employees' wages in the year the benefit is received. IRS Ann. 85-113,1985-31 I.R.B. 31 (Aug. 5, 1985)

Employer's Election of When to Withhold

Employer may elect to treat taxable fringe benefits as paid on a pay period, quarterly, semi-annual, or annual basis, but no less frequently than annually. IRS Ann. 85-113, 1985-31 I.R.B. 31 (Aug. 5, 1985)

Alternative Rule for Income Tax Withholding

Employer may elect to add taxable fringe benefits to employees' regular wages and withhold on total or may withhold on the benefit at the supplemental wage rate of 25%. Reg. §31.3402(g)-1 Reg. §31.3501(a)-1T

See Chapter "Other Types of Compensation"

FRINGE BENEFITS

Special Accounting Rules - cont.

Special Accounting Period

Benefits provided in November and December may be treated as paid in the subsequent year.

IRS Ann. 85-113,1985-31 I.R.B. 31 (August 5, 1985)

An employer may use this rule for some fringe benefits and not others. The special accounting period need not be the same for each fringe benefit. If an employer uses the special accounting period rule for a particular benefit, the rule must be used for all employees who receive the same fringe benefit.

Employer's Election Not to Withhold Income Tax

Employer may elect not to withhold income taxes on the taxable use of employer's vehicle that is includible in wages if: (1) the employer notifies the employee, and (2) the employer includes the benefit in the employee's wages on the W-2 and withholds required social security/Medicare

IRC §3402(s)(1)

⇨ **Note**: This election is available for employer-provided vehicles only. An employer does not have a choice to withhold or not withhold on other taxable fringe benefits.

Reporting Fringe Benefits

REPORTING FRINGE BENEFITS	
EMPLOYEES	**INDEPENDENT CONTRACTORS**
IF Benefit Fully or Partially Taxable: **Report on W-2 as Wages** Subject to withholding for income tax, social security, and Medicare as well as applicable employer taxes.	**IF Benefit Fully or Partially Taxable:** **Report on 1099-MISC** Report if $600 or more paid in calendar year. No payments in any amount are subject to income tax withholding, social security, or Medicare withholding**.**
IF Benefit Fully Non-Taxable: **DO NOT REPORT TO IRS.**	**IF Benefit Non-Taxable**: **DO NOT REPORT TO IRS.**

ACCOUNTABLE PLANS

Definition

IRC § 62(c)
Pub 463

ACCOUNTABLE PLAN

An allowance or reimbursement policy (does not have to be a written plan) where amounts are non-taxable to the recipient if certain requirements are met:

- There must be a business connection to the expenditure.
- There must be "adequate" accounting by the recipient within a reasonable period of time.
- Excess reimbursements or advances must be returned within a reasonable period of time.

Requirements

Business Connection

Reg. §1.62-2(d)

Business connection means that the expense must be a deductible business expense incurred in connection with services performed as an employee. If not reimbursed by the employer, the expense would be deductible by the employee on the employee's 1040 income tax return as a business expense.

Adequate Accounting

Reg. §1.62-2(e)
Reg. §1.274-5T(b)(2)

Verify date, time, place, amount and business purpose of expenses. Receipts are required unless the reimbursement is made under a per diem plan. (See the Per Diem and Actual Expense Reimbursements chapter.)

Timeliness Return of Excess Reimbursements

Reg. §1.62-2(f)

Return any excess reimbursement within a reasonable period of time. A reasonable period of time depends on facts and circumstances. See the next section on timeliness safe harbors.

ACCOUNTABLE PLANS

Timeliness Safe Harbors for Substantiating Expenses and Returning Excess Reimbursements

If an employer uses either of the following methods, the requirements of timely substantiation and return of excess advances/reimbursements will be considered met. Reg. §1.62-2(g)

Fixed Date Method Reg. §1.62-2(g)(2)(i)

Advance is made within 30 days of when an expense is paid or incurred, and the
Expense is substantiated within 60 days after it is paid or incurred, and
Any excess amount is returned to the employer within 120 days after the expense is paid or incurred.

Note: Maximum number of days is 150.

Periodic Statement Method Reg. §1.62-2(g)(2)(ii)

Substantiation and return of excess is within 120 days after the employer provides employee with a periodic statement (at least quarterly) stating any excess amounts are required to be returned.

Note: Maximum number of days is 210.

Other Timeliness Method

Other Reasonable Method Reg. §1.62-2(g)(1)

If an arrangement doesn't meet one of the safe-harbor methods, it may still be considered timely, if it is reasonable based on the facts and circumstances.

Example: An employee on an extended travel assignment might have a longer period to substantiate expenses and return any excess allowance than an employee on a single overnight trip.

ACCOUNTABLE PLANS

More Information on Accountable Plans

Other Rules for Employer Accountable Plan(s) Reg. §1.62-2(j)

- Employers can have multiple expense allowance policies.
- Employers can have both accountable and non-accountable plans for different types of reimbursements.
- Employers may have more restrictive plans than IRS, but not less restrictive for excludable treatment.
- Employee(s) cannot compel the employer to establish a plan.

Non-Accountable Plan

Reg. §1.62-2(c)(3)

Definition Pub 463

An allowance or reimbursement program that does not meet all three requirements for an accountable plan.

Payments made under a **non-**accountable plan are a taxable wage to the employee when paid or when constructively received by an employee.

Withholding Requirements

Reg. §1.62-2(h)

When to withhold depends on whether payments are made under an accountable or non-accountable plan.

Under an Accountable Plan Reg. §1.62-2(h)(2)(i)

If an employer has an accountable plan but an employee does not timely account for expenses or return excess amounts, the employer must withhold employment taxes no later than the first payroll period following the end of the reasonable period.

ACCOUNTABLE PLANS

Withholding Requirements - cont.

Under a Non-Accountable Plan Reg. §1.62-2(h)(4)(ii)

If advances and reimbursements are made under a non-accountable plan, withholding is required when the advances or reimbursements are made to the employee.

Late Substantiation or Return of Excess Reg. §1.62-2(h)(2)

If an employee substantiates expenses and returns excess advances *After* the employer has treated amounts as a wage, the employer is not required to return any withholding or treat amounts as non-taxable.

Travel Advances

To prevent a financial hardship to employees who will be traveling away from home on business, employers will often provide advance payments to cover the costs incurred while traveling. There must be a reasonable timing relationship from when the advance is given to the employee, when the travel occurs and when it is substantiated. There must also be a relationship to the size of the advance and the estimated expenses to be incurred.

Accountable plan advances

Travel advances are not treated as wages and are not subject to income and employment taxes when they are paid under an accountable plan. They must be for travel expenses related to the business of the employer, substantiated by the employee, and any excess returned in a reasonable period of time. Reg. §1.62-2(c)(4)

If employee does not timely substantiate expenses or return excess advances, the advance is includible in wages and subject to income and employment taxes no later than the first payroll period following the end of the reasonable period. Reg. §1.62-2(h)(2)

The determination of a reasonable period of time will depend on the facts and circumstances. Timelines are provided as a safe harbor for employers to use. After the end of the calendar year and once included in wages, an employer cannot go back and reverse the transaction unless the amount was erroneously treated as wages. Reg. §1.62-2(g)(1)

ACCOUNTABLE PLANS

Travel Advances - cont.

Non-accountable plan advances Reg. §1.62-2(h)(4)(ii)

Taxable to the employee and subject to withholding when the advances or reimbursements are made to the employee.

Advances that cross a calendar year Reg. §1.62-2(h)(2)

Taxable to the extent they are not substantiated by the employee no later than the first payroll period following the end of the reasonable period. A reasonable period may end in the year after the advance was made. After the end of the calendar year and once included in wages, an employer cannot go back and reverse the transaction, unless the amount was erroneously treated as a wage at the time of inclusion.

Examples

(1) A small state agency pays a monthly mileage allowance of $200 to certain employees. The agency does not require the employees to substantiate their expenses or return any excess. Is the allowance a taxable wage to the employees, and if so, when?

The mileage allowance does not meet the rules for an accountable plan and therefore, is a non-accountable plan. The $200 allowance is a taxable wage to the employees when paid to them. The employees would receive $200 less the withholding for social security, Medicare and income taxes. Also, the employer must match the social security and Medicare contributions.

(2) An agency puts an accountable plan into effect that requires employees to account for their business mileage and return any excess allowance. Two of the employees account for their mileage but fail to return the excess. Is the allowance a taxable wage to the employees and if so, when?

The mileage allowance meets the requirements of an accountable plan But, since the excess allowance was not returned, the excess is a wage to the two employees and is subject to withholding for income, social security, and Medicare taxes. The withholding is required no later than the first payroll period following the end of the reasonable period .

ACCOUNTABLE PLANS

Form W-2 Reporting

Pubs. 15/ 463/1542
Form W-2 Instructions

Generally, payments made under an accountable plan are excluded from the employee's gross income and are not reported on Form W-2. However, if you pay a per diem or mileage allowance and the amount paid exceeds the amount the employee substantiated under IRS rules, you must report the excess as wages on Form W-2 . The excess amount is subject to income tax withholding and social security and Medicare taxes. Report the amount substantiated (i.e., the nontaxable portion) in box 12 using code L. (See page 9 of 2002 Form W-2 Instructions.) **Note: This chart is for the 2002 Form W-2.** Make sure you have the current year's correct form and instructions. The box numbers and codes are subject to change annually.

From Publication 463, page 30.

TYPE OF REIMBURSEMENT EMPLOYER	W-2 REPORTING*
Under an Accountable Plan	
Actual expense reimbursement: Adequate accounting made and excess returned	No amount reported
Actual expense reimbursement: Adequate accounting and return of excess both required but **excess** not returned	The **excess** amount reported as wages in Boxes 1, 3, and 5. Taxes withheld are reported in Boxes 2, 4, and 6.
Per diem or mileage allowance up to the Federal rate: Adequate accounting and **excess** returned	No amount reported
Per diem or mileage allowance up to the Federal rate: Adequate accounting and return of excess reimbursement both required but **excess** not returned	The **excess** amount reported as wages in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6. The **amount up to the Federal rate** is reported only in Box 12, Code L - it is not reported in Boxes 1, 3, and 5.
Per diem or mileage allowance exceeds the Federal rate: Adequate accounting but **excess** reimbursement over Federal rate not returned	The **excess** amount reported as wages in Boxes 1, 3 and 5. The **amount up to the Federal rate** is reported only in Box 12, Code L - it is not reported in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6.
Under a Non-Accountable Plan	
Either adequate accounting or return of excess, or both, not required by plan	The entire amount reported as wages in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6.
NO REIMBURSEMENT PLAN	The entire amount reported as wages in Boxes 1, 3 and 5. Taxes withheld are reported in Boxes 2, 4, and 6.

TRAVEL EXPENSE REIMBUSEMENTS

Background

Reimbursements received by an employee who travels on business outside of the area of his/her tax home may be excludable from wages. In order to determine if a reimbursement is excludable, you must first understand key travel definitions. This chapter discusses:

IRC §162(a)
Pub. 463
Pub. 535

- Travel expenses
- Tax home
- Away from home
  - Overnight/sleep or rest rules
- Temporary vs. indefinite travel expense
- Substantiation methods

Travel Expenses

Excludable travel expenses are expenses incurred for travel on business away from the general area of the employee's tax home on a temporary basis. In order to have excludable reimbursements, the travel must be temporary and be substantially longer than an ordinary day's work, requiring an overnight stay or substantial sleep or rest.

IRC §162(a)(2)
Pub. 463

Travel expense reimbursements include:

- Costs to travel to and from the business destination
- Transportation costs while at the business destination
- Lodging, meals and incidental expenses
- Cleaning, laundry and other miscellaneous expenses

If an employer reimburses an employee for business related travel expenses, the reimbursement is not taxable to the employee, provided the accountable plan rules are met.

Example: An employee works for an agency in Salem and travels to Pendleton to conduct business for an entire week. The employee incurs the cost of transportation to and from Pendleton as well as lodging and meals while there.

Since the employee is traveling away from his/her tax home on the employer's business for substantially longer than a day, the employee would be considered in travel status. Reimbursement for substantiated travel expenses incurred by the employee would be considered an excludable travel expense.

TRAVEL EXPENSE REIMBUSEMENTS

Tax Home

Pub.463

Identifying the employee's tax home is critical because the Code only permits an excludable reimbursement for travel expenses incurred while the employee is away from home[tax home]. In most cases, the employee's tax home is the *general vicinity of his principal place of business*. The taxpayer may receive excludable travel reimbursements while temporarily away from the tax home in the pursuit of business. Whether the taxpayer's tax home is his employer's business office or his residence, it includes the entire metropolitan area so that the taxpayer is not away from home unless he leaves the metropolitan area.

Rev. Rul. 73-529
Rev. Rul. 93-86

One Regular or Main Place of Business

Generally, the tax home is the employee's regular place of business or official duty station, regardless of where the employee maintains a family home.

> **Example:** An employee lives and works in Albany. The Albany area is considered the employee's tax home.

> **Example:** An employee lives in Albany, but works permanently in Portland. Even though the employee lives in Albany, Portland is considered the employee's tax home.

More Than One Regular or Main Place of Business

If an employee has more than one regular place of business, the tax home is the employee's main place of business. The main place of business is generally determined by the time worked, degree of business activity, and income earned in each location.

> **Example:** An hourly employee works in his employer's office in Portland three weeks a month and in a satellite office in Salem for one week a month. Portland is the employee's tax home.

No Regular or Principal Place of Business

Rev. Rul. 73-529
Rev. Rul. 93-86
Pub.463

An employee may have a tax home even if he/she does not have a regular or main place of business. If the employee works in the

Tax Home - cont.

Pub.463

No Regular or Principal Place of Business - cont.

general area of the residence where he/she regularly lives, the general area of that residence is the tax home. (Factors to determine whether there is a tax home are found in the Revenue Rulings and Publication cited.)

> **Example:** A forestry worker has a home in a remote location and works at various forest sites in the general area. His employer doesn't have an office where the employee works or reports. The general area of his residence may qualify as the employee's tax home.

Tax Home Election for State Legislators

IRC §162(h)(1)B)
TAM 9127009

Section 162(h) of the Code provides that a state legislator whose district is more than 50 miles from the capitol building may elect to treat her residence within the legislative district she represents as her tax home.

> **Example:** The tax home of a legislator from Pendleton is Salem. If the legislator elects to have Pendleton as a tax home, reimbursements for meals and lodging while in Salem may be excludable.

Away From Tax Home - The Overnight Rule

Rev. Rul. 75-170
Rev. Rul. 75-432

In order for a reimbursement of an expense for business travel to be excludable from income, including meals and lodging, a taxpayer must travel "away from home" in the pursuit of business on a temporary basis.

The statutory phrase *"away from home"* has been interpreted by the Supreme Court***** *to require a taxpayer to travel overnight, or long enough to require substantial "sleep or rest"*. Thus, merely working overtime or at a great distance from the taxpayer's residence does not justify receiving excludable reimbursements for travel expenses if the taxpayer returns home without spending the night or stopping for substantial "sleep or rest".
See the chapter on Meal Allowances for further discussion of the "sleep or rest rule".

Supreme Court Case - *U.S. v Correll, 389 U.S. 299, 302-303 (1967)

TRAVEL EXPENSE REIMBUSEMENTS

Away From Tax Home - The Overnight Rule

COURT CASES/RULINGS- SLEEP OR REST RULE

Sleep/Rest Not Met - Reimbursements Taxable

U.S. v Correll, 389 U.S. 299, 302-303(1967)
Barry v. Commissioner, 27 AFTR 2d 71-334, 435 F2d 1290(CA1 1970)
Coombs v. Commissioner, 608 F2d 1269, 1276(1979)
Fife v. Commissioner, 73 T.C. 621(1980)
Rev.Rul. 68-663, 1968-2 C.B. 71
Matteson v. Commissioner, T.C. Memo 1974-96
Unger v. Commissioner, T.C. Memo 1986-64, 51 TCM 455

Sleep/Rest Met - Reimbursements Not Taxable

Williams v. Patterson, 286 F.2d 333 (5th Cir. 1961)
Rev. Rul. 75-170, 1975-1 CB 60
Anderson, David, (1952) 18 TC 649
Weaver, Don, (1953) PH TCM 54001, 12 CCH TCM 1421
Rev. Rul. 75-168, 1975-1 CB 58
Johnson, Mose, (1982) TC Memo 1982-2
Rev. Rul. 75-432, 1975-2 CB 60
L-1711 - Fed Tax Coor.
Siragusa v. Commissioner, T.C. Memo 1980-68

Court Case 1: Williams v. Patterson

A railroad conductor regularly rents a hotel room near railroad station where he sleeps and eats during a 5-hour layover during an 18-hour workday. He may deduct his meal and lodging costs because his layover is long enough to obtain sleep or rest and is required by his job to do so.

Court Case 2: Barry v. Commissioner

A consulting engineer works with clients in a three state area by making one-day trips to each client. She frequently leaves home at 6:30 a.m. and does not return until midnight. During the day, she stops in a rest area and closes her eyes for 20 minutes to refresh herself for the drive. She cannot deduct the cost of her meals on these trips because she is not away from home long enough to obtain substantial sleep or rest.

Court Case 3: Unger v. Commissioner

A truck driver's "safety breaks" which consisted of resting or sleeping at the wheel of the truck for periods ranging from 45 minutes to three and one-half hours, were considered by the courts to be a mere pause from his daily work routine and consequently did not constitute a substantial amount of sleep or rest. So the truck driver was not considered to be away from home.

TRAVEL EXPENSE REIMBUSEMENTS

Away From Tax Home - The Overnight Rule - cont.

Examples:

1) **An employee is required to travel from Salem to Portland to work on a project. She leaves home at 11:00 a.m. on Monday, with plans to return home the same day. She is unable to complete the project on Monday, so she spends the night in Portland. After completing the project the next day, she returns to Salem by 10:30 a.m.**

   Even though the employee had not planned to spend the night and is gone for less than 24 hours she has met the "Away From Home" rule because she spent the night away from her tax home on business.

2) **An employee is required to travel from Eugene to Portland to work for the day. The employee leaves home at 6:30 A.M. and returns that night at 10:00 P.M. On the trip home the employee stops for dinner and rests in the car for two hours. Does this stop meet the substantial "sleep or rest" requirement?**

   Even though the employee has been away from home for substantially longer than his/her normal work day, the employee is not considered to be in travel status. Court cases have ruled that stopping for a meal or a rest in a car does not meet the substantial "sleep or rest" rule.

3) **A government agency supplies office equipment to all agencies within the state. An employee drives a tractor-trailer with equipment from the warehouse in Beaverton to an agency in Medford. After 10 hours the driver stops and rents a room at a rest stop for a 4 hour nap before completing the round trip.**

   Since the driver rented a room in order to sleep, he/she is considered to have met the "sleep and rest" rule. Reimbursements for meals and lodging are not taxable to the employee.

"Temporary" vs "Indefinite" Travel Assignments

Rev. Rul. 93-86
Rev. Rul. 99-7

Reimbursements of travel expenses for "temporary" assignments away from the tax-home are generally not taxable to the employee. If the assignment is "indefinite", the employee is considered to have moved his/her tax home to the new work location. Reimbursements of expenses for "indefinite" travel are taxable.

TRAVEL EXPENSE REIMBUSEMENTS

"Temporary" vs. "Indefinite" Travel Assignments - cont.

Rev. Rul. 93-86
Rev. Rul. 93-7
Pub. 463

The Internal Revenue Service looks at all of the facts to determine whether the travel assignment was intended to be temporary or indefinite.

⇨ **Note**: The decision of whether an assignment is realistically expected to last less than one year is made when the assignment begins.

"Temporary" Travel Assignments

- *Duration at a single location realistically expected to last and actually lasts one year or less*
- Assignment is away from the principal place of work overnight
- Tax home hasn't changed
- If going home on days off:
  Lesser of travel expenses home or cost of staying at temporary assignment are excludable.

Examples of possible **excludable** travel expenses:
Meals and lodging at temporary work location

"Indefinite" Travel Assignments

Reimbursement of expenses for "indefinite" assignments away from the tax home are generally taxable as a wage to the employee. Rev. Rul. 93-86

- Duration at a single location is realistically expected to last longer than one year or actually lasts one year or longer

- New assignment location is considered the new tax home

Examples of **taxable** travel reimbursements:
Meals and lodging at indefinite work location

"Temporary" Travel Assignments Become "Indefinite"

If initially an assignment away from home at a single location is realistically expected to last one year or less, and then later it is realistically expected to last longer than one year, the assignment is considered temporary *until* the date the expectations change. At that time, the travel is considered "indefinite" and any travel reimbursements from this date on are taxable.

TRAVEL EXPENSE REIMBUSEMENTS

"Temporary" vs. "Indefinite" Travel Assignments - cont.

Examples:

1) **Joan accepts a 6 month work assignment away from her tax home intending to return to her tax home at the finish of the temporary assignment. The assignment lasts for 6 months and Joan returns to her regular job at her tax home. Are reimbursements for Joan's travel and living expenses at her temporary assignment taxable to her?**

   Joan's reimbursements are excludable because the assignment was intended to last for less than one year and did last less than one year.

2) **Joan accepts a temporary assignment away from her tax home for 6 months, intending to return to her tax home at the finish of the temporary assignment. After 4 months at the temporary job assignment, Joan agrees to stay for an additional 14 months. Are reimbursements for Joan's travel and living expenses at her temporary assignment taxable to her?**

   Joan is not taxed on employer reimbursements for travel expenses paid or incurred during the first 4 months of her temporary assignment. Joan will be taxed for reimbursements for the additional 14 months because the assignment has now become an indefinite assignment. If there had been a reasonable basis at the start of the assignment to believe that it would be extended, then it would have been considered indefinite from the start.

3) **Joan accepts an assignment away from her tax home for 15 months. After 7 months, the employer cancels the assignment and Joan returns to work at her tax home. Are any of the reimbursements for Joan's travel and living expenses during the 7 months of her assignment taxable to her?**

   Although Joan's assignment lasted for less than one year, it had been realistically expected to last for more than one year when the assignment began. Therefore, the assignment was considered "indefinite" and the reimbursements for the 7 months are taxable.

PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

Background

Rev. Proc. 2002-63
Reg. §1.274-5(j)(1)
Pub. 1542

Generally, employers reimburse employees for ordinary and necessary business expenses incurred **while traveling away from home overnight.** Employers may reimburse the actual expenses, in which case, the employees will have to substantiate the expenses with receipts. Or an employer may reimburse for travel expenses using a per diem allowance method.

A per diem is an allowance per day to pay for lodging, meal and incidental expenses while traveling on business. The amount of the expenses reimbursed under a per diem allowance method will be deemed (considered) substantiated without receipts provided the requirements of the regulations are met.

Excludable When Paid Under Accountable Plan

Key Requirements:

Reg. §1.62-2(c)

- Business Connection — Pub. 535/463
- Substantiation — Reg. §1.274-5T
  Elements required for substantiation:
  (1) Amount, (2) Time and Date, (3) Place, (4) Business Purpose — Reg. §1.274-5T(b)(2)
- Excess returned within a reasonable time

Example: James, who lives and works in Portland, is required to go to Bend for the week on business. His employer will reimburse him for his lodging and meal expenses. His employer requires him to adequately substantiate the expenses he incurs while on the trip.

If James provides the required substantiation, the reimbursement he receives would not be taxable to him. If, however, he fails to provide adequate substantiation, then any reimbursement he receives for the unsubstantiated amount would be taxable to him.

Per Diem Rules

Rev. Proc. 2002-63

- If a per diem allowance is used, employees are "deemed" to have substantiated the ***amount*** of expenses equal to the lesser of the IRS per diem rate or the per diem allowance paid by the employer (if less than the IRS rate).

PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

Per Diem Rules - cont.

Rev. Proc. 2002-63

- The per diem must be at or less than Federal rates to be fully excludable.

- Deemed substantiation provides an alternative to providing receipts or bills for actual expenses.

- No receipts are required if a per diem allowance is used, but the payments still must meet the other substantiation requirements including time (date), place, and business purpose.

- An employer's substantiation requirements must meet the Federal requirements at a minimum. An employer may have more stringent requirements, such as requiring meal and/or lodging receipts.

  Example: An employee traveling away from home on business is reimbursed by his employer at the federal per diem rate for the city in which he spends the night.

  Since the employee is reimbursed at the federal per diem rate for the city in which he spends the night, the employee does not have to provide receipts. However, the employee must still provide adequate substantiation verifying the time, place and business purpose of the trip. The employer may require additional substantiation.

Federal Per Diem Rate - Breakdown

Federal per diem rates are broken down for lodging, meals, and incidental expenses **(M&IE).** Rev. Proc. 2002-63

Lodging Includes:
Only the cost of the lodging. Room tax and energy surcharges are not considered part of the lodging cost.

M&IE Includes:
Meals, tips and fees for food and luggage handling type services.

An employer is not required to reduce the M&IE even if meals are provided in-kind to the employee, if the employer reasonably believes that the M&IE will be incurred.

PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

Federal Per Diem Rate - Breakdown - cont.

Rev. Proc. 2002-63

M&IE Does Not Include Miscellaneous Expenses

Miscellaneous expenses are not part of M&IE and, therefore, reimbursements of miscellaneous expenses, in addition to the M&IE allowance, may be excludable from wages.

Miscellaneous Expenses

Miscellaneous expenses are not considered part of a per diem reimbursement and, therefore, substantiation is required. Employers may require actual receipts or written certification as substantiation depending on their travel policies.

Miscellaneous expenses include cab fares, fax, telephone charges, room taxes, energy surcharges, laundry, cleaning and pressing of clothes, and other business related expenses.

Travel for Days of Departure and Return

Rev. Proc. 2002-63
Pub. 463

For both the day travel begins and the day travel ends, the per diem meal allowance is to be prorated by one of two methods:

- Claim ¾ of the per diem meal allowance, or
- Use any method that is consistently applied and that is in accordance with reasonable business practice, such as the actual hours away from home on the first and last day.

Traveling to More Than One Location

Rev. Proc. 2002-63
Pub. 463

If traveling to more than one location in one day, use the per diem rate for the area where *stopping for rest or sleep.*

PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

Per Diem Paid Under a Non-Accountable Plan

Pub. 535/463
Reg. §1.62-2(a)(4)

A per diem plan that fails to comply with all accountable plan requirements is considered a non-accountable plan.

Per diem payments made under a non-accountable plan are wages subject to federal income tax, social security and Medicare taxes and are reportable on a Form W-2. Employer matching is required for social security and Medicare taxes.

Example: An employee regularly travels as part of her job requirements. The employer provides her with a monthly per diem allowance based on an estimate of the number of days traveled. The employee is not required to return any of the allowance that exceeds substantiated business expenses.

Since the employer does not require the employee to return excess advances or allowances, the entire amount of the allowance is taxable to the employee as a wage.

Other Per Diem Methods

Rev. Proc. 2002-63
Pub. 1542

Meals-Only Substantiation Method

An employer may reimburse the actual lodging expense and use the M&IE per diem allowance plan for the meals and incidentals expense.

High-Low Substantiation Method of Substantiation

The high-low substantiation is another deemed substantiation method that may be used in place of the per diem method. The IRS designates key cities or localities as "high-cost" areas. All other localities are considered "low-cost" areas. Rather than having different rates for each city, a single per diem rate is assigned to all high-cost areas and all other areas are assigned another rate. An employer that uses the high-low method for an employee must use the high-low method for that employee for the entire year, unless an actual expenses method is used.

PER DIEM AND ACTUAL EXPENSE REIMBURSEMENTS

Substantiation Methods

Travel away from home reimbursements may be provided by an employer using either an *actual expense* or *per diem reimbursement* method.

TRAVEL AWAY FROM HOME *OVERNIGHT* - Substantiation Methods

Actual Expense Reimbursement – Excludable from Wages:

- Must be paid under accountable plan to be excludable
- Amount, date & time, place, business purpose must be proven
- Based on what is actually spent
- Contemporaneous records such as receipts must be kept
- Expenses must not be lavish but reasonable based on circumstances
- If not away from home overnight, meal reimbursements are taxable even if actual receipts are provided

Per Diem Meal Allowance (M&IE) – Excludable from Wages: Rev. Proc.2002-63

- Must be traveling on business away from home overnight or meet the "sleep or rest" requirements to be excludable
  (See chapter "Travel Expense Reimbursements" for sleep or rest requirements.)
- Provides a set dollar amount depending on where and when traveling instead of keeping actual cost records BUT must still keep records to prove the date and time, place, and business purpose of travel.
- Allowance prorated for partial travel days
  (Day of departure and return)
- If traveling to more than one location in one day, use rate for area where *stopping for rest or sleep.*

TRANSPORTATION EXPENSE REIMBURSEMENTS

Transportation Expenses

Pub. 463
Rev. Rul. 99-7

Transportation expenses are costs for local business travel that is ***not*** away from the tax home area overnight and is in the general vicinity of the principal place of business. Travel expenses are expenses for travel away from your tax home overnight.

Reimbursement of expenses for local transportation for "temporary" assignments are generally not taxable to the employee.

Transportation expenses may include:

- Air, train, bus, shuttle and taxi fares in area of tax-home
- Mileage expenses or costs of operating a vehicle
- Tolls and parking fees

Transportation expenses do not include:

- Meal and lodging costs
- Commuting to regular or principal place of business

Substantiation Methods – Transportation Expenses

Excludable When Paid Under an Accountable Plan

Reg. §1.62-2(c)
Pub. 535/463

Key Elements:

- Business Connection
- Substantiation — Reg. §1.274-5T(b)(2)
- Excess returned within a reasonable time

Actual Transportation Expense Reimbursement – Excludable from Wages:

- Must be paid under accountable plan to be excludable — Reg. §1.274-5T(b)(2)
- Amount, date and time, place, business purpose (and business relationship for entertainment expenses) must be proven
- Based on what is actually spent
- Contemporaneous records such as receipts must be kept
- Must not be lavish; must be reasonable based on circumstances

TRANSPORTATION EXPENSE REIMBURSEMENTS

"Temporary" vs. "Indefinite" Transportation Assignments

Reimbursement of transportation expenses for "temporary" assignments in the general area of the tax-home may not be taxable to the employee. Reimbursements of expenses for "indefinite" transportation expenses may be taxable.

ILM 199948019
Pub. 463
Rev. Rul. 99-7

The "temporary" and "indefinite" rules only apply to going between an employee's *residence* and a work location, regardless of the distance. The Internal Revenue Service looks at all of the facts to determine whether the travel assignment was truly intended to be temporary.

⇨ **Note:** The decision of whether an assignment is realistically expected to last more than one year is made when the assignment begins.

Temporary Transportation Expenses

- *Duration at a single location realistically expected to last, and actually lasts, one year or less*
- Assignment is away from the main place of work
- Not considered commuting
- Examples of possible excludable transportation reimbursements:
  Mileage, parking

Indefinite Transportation Expenses

- *Duration at a single location realistically expected to last longer than one year*
- Assignment location is away from principal place of work
- Examples of taxable transportation expense reimbursements:
  Mileage, parking that exceeds certain transportation fringe benefit limits — IRC 132(f)
- A break of 7 months generally constitutes a new assignment

"Temporary" Transportation Assignments Become "Indefinite"

If initially a local assignment at a single location is realistically expected to last one year or less, and then later it is realistically expected to last longer than one year, the assignment is considered temporary *until* the date the expectations change. At that time, the transportation is considered "indefinite" and any reimbursements from this date are taxable.

TRANSPORTATION EXPENSE REIMBURSEMENTS

"Temporary" vs. "Indefinite" Transportation Assignments – cont.

Examples

(1) Tom, a state auditor, is assigned to an audit of another agency that is expected to take, and does take, 18 months to complete. The agency he is auditing is in the same town as his regular place of business. Tom travels daily from his residence to the office of the agency he is auditing and is reimbursed for his mileage by his employer. Are the reimbursements for mileage taxable to Tom?

Although Tom is not traveling away from his tax home area, the travel is considered "indefinite" since the audit is expected to take more than one year. The reimbursements for mileage are a taxable wage to Tom.

(2) In Example 1, if Tom had traveled from his main place of business rather than from his residence, the reimbursements could be excludable because he wasn't traveling from his residence so the "temporary vs. indefinite" rules don't apply.

Transportation Expenses Versus Commuting Expenses

It is important to distinguish transportation expenses from commuting expenses. Commuting is going between an employee's personal residence and main or regular pace of work. Reimbursements of transportation expenses for getting from one workplace to another in the course of the employer's business when traveling within the general area that is your tax home may be excludable from wages, whereas reimbursements for commuting are not excludable.

Reg. §1.162-2(e)

Nontaxable (Excludable) Business Transportation

1. An employee with a one or more regular workplaces drives from her residence to a temporary job site, either within the area of your tax home or outside that area.
2. An employee drives from his regular office (or job location) to a temporary work site.
3. An employee drives from a first job to a second job.
4. An employee drives between temporary job sites.
5. An employee works at two places in one day and drives between work sites whether or not for the same employer.
6. An employee has an office in the home that qualifies as a principal place of business and drives between the home and another work location in the same trade or business.

TRANSPORTATION EXPENSE REIMBURSEMENTS

Transportation Expenses Versus Commuting Expenses – Cont.

Taxable Commuting

1. An employee drives from his residence to his principal or regular workplace(s) (during or after work hours, required or not by employer).
2. An employee drives from her residence to her regular workplace on the weekend because of an urgent meeting convened by her employer.
3. An employee has an office in the home that qualifies as a principal place of business and drives between the home and another work location in a different trade or business.
4. An employee with no regular or main place of business drives between his residence and his first and last business stops.

Examples – Transportation vs Commuting

(1) An employee drives from her home in Silverton to her office in Salem. In the afternoon she drives to Albany to deliver papers at a satellite office and returns to her residence.

The trip between the employee's home and regular place of business in Salem is personal commuting and any reimbursement for this part of the trip is taxable to her as a wage. Assuming the accountable plan rules are met, reimbursement for the travel from her office to the temporary work site in Albany and the return trip home is excludable.

(2) A Fish and Game warden lives in a remote area and doesn't have a regular place of business. He drives daily to various, temporary job locations and is reimbursed for his mileage. Are any of his reimbursements taxable as a wage?

Reimbursements for the daily travel between the employee's residence and the first and last work locations are taxable as a wage because the game warden doesn't have a regular place of business and he isn't driving to a work site outside of the general area of his residence. Reimbursements for travel between the work sites is not taxable.

(3) An employee travels from his residence to a temporary work site for the day, driving past his official duty station on the way. Is reimbursement for the mileage from the residence to the temporary work site excludable, or is it limited to the distance from the official duty station if it is less?

Reimbursements for transportation between the residence and the temporary work site may be excludable because that is the actual distance traveled. See ILM 199948018.

TRANSPORTATION EXPENSE REIMBURSEMENTS

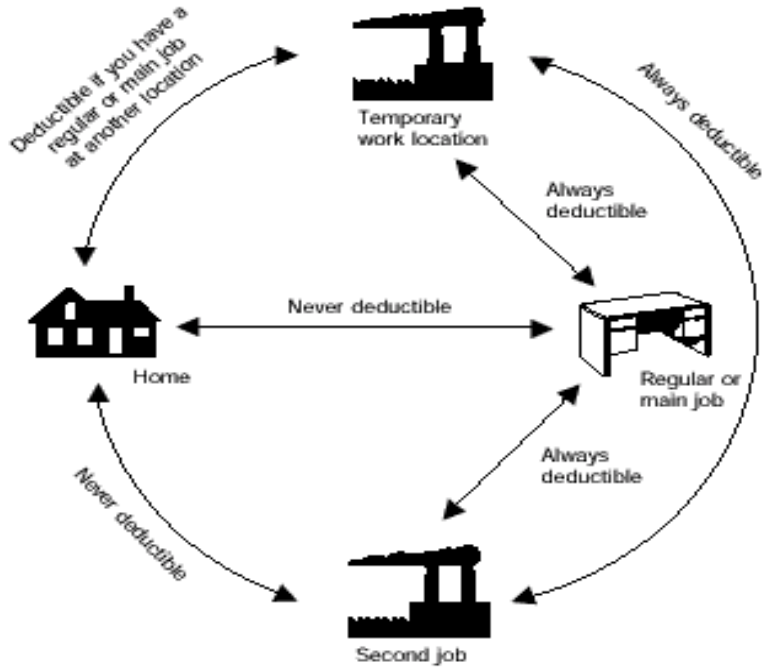
Transportation Expenses Versus Commuting Expenses – Cont.

Examples – Transportation vs Commuting – cont.

(4) A high-school music teacher is assigned to two schools on a permanent basis. She works at the first school in the morning and drives from the first to the second school in the afternoon. She is reimbursed for her travel between the two locations. Is the reimbursement taxable?

*The travel is not taxable to the teacher because she is traveling between work sites***.**

Deductible expenses in the illustration below are excludable from wages if reimbursed by an employer. Pub. 463.



Home: The place where you reside. Transportation expenses between your home and your main or regular place of work are personal commuting expenses.

Regular or main job: Your principal place of business. If you have more than one job, you must determine which one is your regular or main job. Consider the time you spend at each, the activity you have at each, and the income you earn at each.

Temporary work location: A place where your work assignment is realistically expected to last (and does in fact last) one year or less. Unless you have a regular place of business, you can only deduct your transportation expenses to a temporary work location outside your metropolitan area.

Second job: If you regularly work at two or more places in one day, whether or not for the same employer, you can deduct your transportation expenses of getting from one workplace to another. You cannot deduct your transportation costs between your home and a second job on a day off from your main job.

MOVING EXPENSES

Background

The expenses incurred to change residences, i.e., to move from one place to another, are considered personal expenses and are to be included in wages UNLESS the move is directly related to work and the expenses meet the criteria set forth under the Internal Revenue Code (IRC) § 217. Personal expenses are not deductible under IRC § 262.

If the moving expenses qualify under IRC § 217, they may be taken as a deduction on the individual's federal income tax return. If the expenses are paid or reimbursed by an employer, the moving expense payment can be an excludable fringe benefit to the employee under IRC § 132(g).

General Rule

A moving expense reimbursement received directly or indirectly from an employer (under an accountable plan) is excludable to the employee if specific tests of IRC §217 are met.

IRC §82 & §217
Pub. 521 & 15-B

Specific Tests:

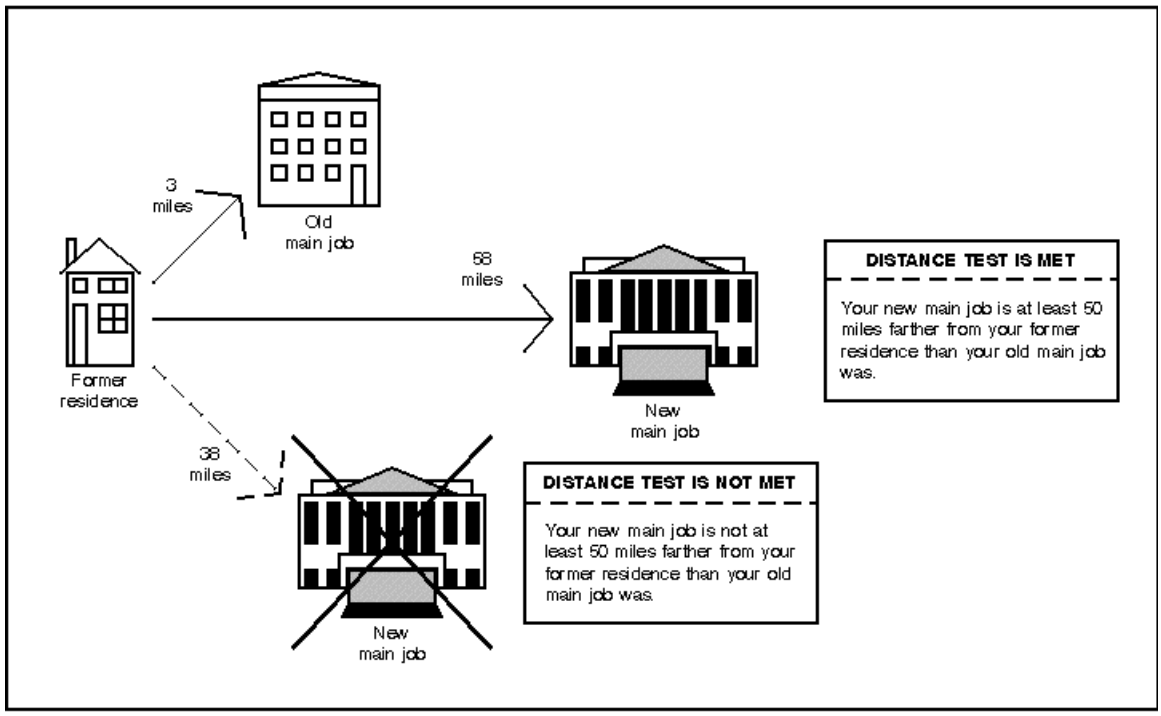
IRC § 217
Pub. 521 & 15-B

- Individual must be an employee
- Employee must actually incur or pay the expenses
- Expenses are closely related to starting work at the new job location (generally moving expenses incurred within 1 year from the date you first report to work at the new location qualify).
- Expenses must meet the time and distance tests-

  Time: Employed 39 weeks (full time), and
  Distance: The <u>New</u> job is at least:
  50 miles farther from the former home than the old job location was from the former home.

MOVING EXPENSES

Figure A. **Illustration of Distance Test**



Definitions

Moving Expenses are the <u>REASONABLE</u> expenses for: IRC § 217(b)

moving household goods and personal effects; and,
the t*ravel costs between the former and the new residence*
<u>by the shortest and most direct route.</u>

Moving Expense Payments Can Be Direct or Indirect: Reg. §1.82-1(a)(3)

Direct payments are made directly to the employee for moving expenses. Indirect payments are made to a third party on behalf of the employee (i.e., a moving and storage co., or an airline, or travel agency).

Travel Time for Traveling Expenses: Pub. 521

An employee can be reimbursed for the cost of transportation and lodging for herself and members of her household while traveling from her former home to her new home. This includes expenses for the day she arrives. An employee can include any lodging expenses she had in the area of her former home within one day after she could not live in her former home (the furniture had been moved). An employee can be reimbursed for traveling expenses for only one trip to her new home for herself and members of her household. However, all family members do not have to travel together or at the same time.

MOVING EXPENSES

Travel Time for Traveling Expenses – Cont.

Begins: 1 day after former residence is no longer suitable for occupancy and includes 1 night lodging at prior residence.

Ends: Date the employee secures lodging at the new place of residence The qualified expenses are deductible only for the first day the employee arrives at the new location.

⇨ **Note:** Any relocation allowances paying for more days than defined above are taxable as wages to the employee.

Delayed Moving

Rev. Rul. 78-200
Reg. §1.217-2(a)(3)

Expenses are deductible even after a 12-month period of arriving, When, for example, one is waiting for dependents to finish school.

Costs and Taxability

Pub. 521, Rev. Proc. 2001-54
Reg. §1.217-2(b)(3) &(4)

COSTS OF TRAVELING TO NEW HOME:	
EXCLUDABLE (Deductible)	**INCLUDABLE (Non-Deductible)**
Moving other household members (not necessary to travel together) Airfare Travel by car:** 14 cents for 2004 or actual gas and oil costs Lodging expenses while traveling Parking Fees Tolls	Pre-Move house-hunting Meals Trips back and forth to prior home Transportation expenses: Car: repairs, general maintenance, insurance and depreciation on vehicle Mileage reimbursement in *excess* of 14 cents for 2004 Living or other expenses related to waiting for movers to arrive or getting into new home
COSTS OF MOVING HOUSEHOLD GOODS/PERSONAL EFFECTS:	
EXCLUDABLE (Deductible)	**INCLUDABLE (Non-Deductible)**
Packing, Crating and transporting goods Connecting/disconnecting utilities Shipping your car and/or pet Storage and insurance of goods (Any period of 30 consecutive days after goods are moved from our former home and before they are delivered to your new home.)	Meals & Lodging in Temporary Home Storage or transporting boat or RV Selling Costs of Prior Residence & Losses Lease cancellation fees Mortgage cancellation fees Cancelled club memberships Unused tuition expenses

**See Pub. 521, page 7 Travel by Car. All household members do not need to travel together or at the same time. You are allowed to move more than one car.

MOVING EXPENSES

Costs and Taxability – Cont.

Tax Treatment IRC §132(a)(6)&(g)

Moving expense reimbursements are *not included in income* if the expenses qualify under IRC § 217 ***and*** are reimbursed in the same calendar year they are deducted.

Reimbursed and employer-paid qualified moving expenses (those that would otherwise be deductible by the employee) are not includible in an employee's income unless you have knowledge that the employee deducted the expenses in a prior year.

If an employer reimburses an employee in the current calendar year for moving expenses that the employee *deducted in an earlier year*, the employer should include the reimbursement in wages subject to withholding taxes (just like their other pay).
(See related example at the end of the text.) Reg. § 1.217-2(a)(2)

Timing of Taxability

An employee is considered a 'cash basis", calendar year taxpayer and is required to include all taxable reimbursements in income in the year received. Reg. §1.82-1(a)(2)

If an employee fails to repay excess advances or reimbursements, the excess amount is included in wages and subject to income tax withholding, social security and Medicare taxes. Reg. §1.82-1(a)(2)

If the employee fails to account to his employer within a reasonable amount of time, the advances or reimbursements are included in wages and subject to income tax withholding, social security and Medicare taxes. Reg. §1.82-1(a)(2)

If the employer advances funds to the employee, any amounts not repaid on the final accounting to the employer are considered received by the employee at that time. . Reg. §1.82-1(a)(2)

A taxpayer may elect to deduct his moving expenses in the year of reimbursement rather than in the year of actual payment. The election is made by claiming the deduction on the return or an amended return for the year of the reimbursement. Reg. §1.217-2(a)(2)

Example: An employee moves in 2002. The employer reimburses the employee in 2003 (the subsequent year). The employee can elect to deduct all moving expenses in 2003.

MOVING EXPENSES

Reporting Moving Expenses

Form W-2 Instructions 2002

Employer's requirements for reporting moving expense reimbursements for employees: (This refers to Form W-2 for 2002. The box numbers and codes are subject to change annually. Please see the W-2 instructions for the tax year you are reporting.)

MOVING EXPENSES	**W-2 Boxes 1,3, and 5**	**W-2 Box 12, Code P**
INCLUDIBLE (TAXABLE): Employer-paid Non-Qualified Subject to withholding income, social security, and Medicare taxes		
EXCLUDABLE (NON-TAXABLE): * Employer-paid Qualified		

* **Note:** Even if all the moving expenses are qualified and excludable from wages, the employer needs to report the moving expense reimbursements on the From W-2 as an information item in Box 12, Code P.

THIRD PARTY MOVING EXPENSES:

Qualified moving expenses an employer pays **to a third party on behalf of the employee** (e.g., to a moving company, airline, etc) and services that an employer furnishes in kind to an employee are **not reported** on Form W-2.

MOVING EXPENSES

Examples

(1) What happens when calendar years are crossed?

An employee moves in November, 2002. The employee received an advance or a reimbursement prior to December 31, 2002. There are additional reimbursable moving expenses after January 1, 2003. There is a choice of how and when to report these reimbursements. The employer may have made taxable and/or non-taxable reimbursements to the employee. At a minimum, the employer has a reporting requirement on the W-2 for the non-taxable or excludable reimbursed moving expenses. The reimbursements made prior to year-end can be included on the current 2002 W-2 and the balance of the reimbursements will be included on the employee's 2003 W-2 (in the next year). The alternative is to report all the reimbursements on the employee's W-2 in the year the move is completed.

(2) A state agency requires an employee to remain at the new location at least 12 months. If the employee leaves before the required period is up, but he repays the agency for all the reimbursements, what is the tax implication?

Assuming that all events happened within a calendar year(nothing has been reported to the IRS in a prior year), there is no tax impact to the state agency and there would be no notation on the employee's W-2. It should be noted that the employee could be entitled to a moving expense deduction on his personal federal tax return. He only has to work as an employee for 39 weeks, and he doesn't have to work for the same employer. The former employee would complete a Form 3903 and file it with his Form 1040 return.

(3) An agency recruits a new employee for a special job and offers him a $10,000 moving bonus as an incentive. The employee accepts the job but does not provide any accounting relating to the move to the employer. How does the employer treat the bonus for tax purposes?

The bonus is treated as additional wages and subject to all withholding taxes. It appears on the employee's W-2 in Box 1, 3, and 5. It is possible that the employee had qualifying moving expenses. The employee can complete a Form 3903 and file it with his Form 1040 return.

MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

General Rules

IRC §119
Pub. 535

The fair market value (FMV) of meals or lodging furnished to an employee by an employer may be nontaxable to the employee **IF** the rules of IRC § 119 are met. If a benefit is deductible by an employee under IRC § 119, it may be excludable from wages. Cash provided for meals is not excludable under this Code section but see the chapter on Meal Allowances/Reimbursements.

Meals excludable from wages of employee if:

- Provided in kind, and
- On employer's business premises, and
- For employer's convenience.

Lodging not excludable from wages of employee if:

- Provided in kind, and
- On employer's business premises, and
- For employer's convenience, and
- Required as a condition of employment

Even if the provisions of a State statute, an employment or union contract say that a meal or lodging is taxable or not taxable, the actual facts and circumstances and the requirements of IRC §119 control the federal taxability. IRC§ 119(b)(1)

Example: An employee of a state institution is required by his employer to reside at the institution in order to be available for duty at all times. Under the applicable State statute, the employee's lodging is regarded as part of the employee's compensation. Is the lodging taxable as a wage to the employee? Reg. §1.119-1(f)

Regardless of the State statute, the employee would nevertheless be entitled to exclude the value of such meals and lodging from his wages because the lodging is provided in kind, is on employer's business premises, for the employer's convenience, and is required as a condition of employment.

If an employee has an option to receive additional compensation in place of actual meals or lodging, then the meals and lodging, if taken, are taxable. Reg. §1.119-1(e)

"In-Kind" Requirement

"**In Kind**"

Means "not cash" (neither cash allowances nor reimbursements qualify)

MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

"On Business Premises" of the Employer

Reg. §1.119-1(c)

Place where employee performs a significant portion of duties
Not "near" premises but within perimeter of business
May include temporary work sites, such as rented hotel conference Room, if business is conducted there.
Public restaurants do not qualify as business premises.

Example: Meals are provided at no cost to employees on a state ferry. Are these meals taxable?

No, the meals are not taxable. The ferry qualifies as the employer's business premises and the employee performs a significant portion of duties there. Meals are furnished for the convenience of the employer since the employer can't stop the ferry to allow the employees to go to lunch.

Meals: "Convenience of Employer"

Reg. §1.119-1(a)(2)

Provided for substantial non-pay reason ("non-compensatory").
Depends on the facts and circumstances.

Examples: Meals Provided for the Convenience of Employer
Meals are furnished during working hours so that employee is available for emergency calls during the meal - e.g. firefighter. (You must have evidence that emergencies occur.)

Meals are furnished to employees in a remote site because there are insufficient eating facilities in the area, e.g. remote logging camp.

An employer has pizza delivered to the office at a group meeting to ensure that the employees return in time for the meeting.

Meals are furnished because the nature of the employer's business restricts an employee to a short meal period (not to allow an employee to leave earlier).

Examples: Meals *Not* Provided for the Convenience of Employer
Meals provided before or after working hours are not for the convenience of employer, unless: Reg. § 1.119-1(a)(2)(ii)(d)

Restaurant or Cafeteria Employee, or
Duties prevent employee from taking meal until immediately after working hours

MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

Meals: "Convenience of Employer" - cont.

Examples: Meals *Not* Provided for the Convenience of Employer – cont.

Free lunches provided by an employer to promote goodwill, boost morale or attract prospective employees are not considered for the "convenience of the employer". — Reg. § 1.119-1(a)(2)(iii)

Meals provided with a charge may or may not be considered for the"convenience of the employer" — IRC § 119(b)(3)

Lodging - "Convenience of Employer"

Reg.§1.119-1(b)

Provided for substantial non-pay reason ("non-compensatory"). Depends on the facts and circumstances.

Lodging provided to the governor is considered for the convenience of the employer. — Rev. Rul. 75-540

Rent subsidized living quarters provided to state legislators do not satisfy the convenience of the employer or condition of employment tests where the legislator is not required to accept. However, there is an election that a legislator may make to have their personal residence treated as their tax home and then the value of the lodging may be excludable as a qualified travel expense. — IRC §162(h)(1)B) TAM 9127009

(See Travel Expense Reimbursements chapter.)

Example: W, a full time executive of the city of Portland, lives in Eugene but works in Portland. The city provides a rented apartment in Portland to help defray the executive's personal commuting costs. Is this arrangement taxable?

The requirements for lodging to be excluded from income have not been met. The lodging is not on the business premises of the employer, and therefore, doesn't qualify.

Lodging - "Required as Condition of Employment"

Reg.§1.119-1(b)

Where the employer requires employees to live on the premises to be able to perform their job duties.
Example: fire fighters, apartment managers

MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

Lodging - "Required as Condition of Employment" - cont.

Employee must be required to accept lodging (cannot be an option). Where lodging is provided as a condition of employment, meals, if provided, may qualify as excludable.

Reg.§1.119-1(a)(2)(i)

Example: An employee at a prison is given the choice of residing at the institution free of charge, or of residing elsewhere and receiving a cash allowance in addition to his regular salary. If he elects to reside at the prison, is the value to the employee of the lodging furnished by the employer includible in the employee's wages?

The value of the lodging is taxable as a wage to the employee because he is not required as a condition of employment to reside on the premises.

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Lodging for Educational Institutions

IRC §119(d)

Excludable Campus Lodging

Qualified campus lodging furnished to employees is not taxable to an employee as a wage, if:

- Lodging is located on or near the campus, and
- Employee pays rent of at least 5% of appraised lodging value, or
- Rent charged to the employee is comparable to rent charged by the institution to students or non-employees.

Taxable Campus Lodging

If the employee pays no rent:
Lesser of 5% of the appraised value or the comparable rent is included in income as a wage.

If the employee pays rent that is less than the 5% or comparable rent:
Difference between what is actually paid and the lessor of 5% of the appraised value or the comparable rent is a wage.

Benefit applies to employees of institution and their spouse and dependents.

MEALS AND LODGING FOR CONVENIENCE OF EMPLOYER

Meals or Lodging Furnished With a Charge

IRC§119(a)(2)

Mandatory Charge

IRC §119 (b)(3)

If an employer charges an employee a fixed amount for a meal or lodging, whether or not taken by the employee, the employee's regular *taxable wage* is reduced by the amount of the charge. If *not* provided for the convenience of the employer, the FMV of meal or lodging is then added to the wage. Generally, the FMV of the meal will be the amount charged for the meal by the employer.

Optional Charge

IRC§119(b)(3)

If an employer provides a meal which an employee may or may not purchase, the employee's taxable wage is *not* reduced by the amount the employee pays for the meal. If the meal is not for the convenience of the employer, the FMV of the meal less any amount charged by the employer is included in the employee's wages.

MEAL ALLOWANCES/REIMBURSEMENTS

Background

IRC §62(c)
Pub. 463

Employers often reimburse employees for meals while traveling away from home overnight or while attending meetings or entertaining customers. The taxability of these reimbursements or allowances depends on whether there is a valid business reason for the meals and whether the expenses are substantiated. Reimbursements or allowances must first meet the accountable plan rules in order to be excludable.

This chapter will cover:

- Meals while traveling away from the tax home overnight
- Meals while not away from home including meals with meetings, entertainment meals, de minimis fringe benefit meals
- Substantiation of employee meal reimbursements and allowances

Meal Reimbursements While Traveling Away From Home on Business

IRC §162(a)(2)
Pub. 463
Rev. Rul. 75-170
Rev. Rul. 75-432

Meals Away From Home Overnight

In order for travel meal reimbursements to be excludable from wages, employees must be traveling away from their tax home on their employer's business. Where employees live has no bearing on where their tax homes are.

Traveling "away from home" means:

1. Employee must be traveling away from the general tax home area substantially longer than an ordinary day's work, and
2. Employee needs to obtain substantial sleep or rest to meet the demands of the work while away from home.

"Sleep or Rest" Requirement

- Away from the area of the principal place of business (tax home)
- Away long enough that returning home is unreasonable
- No set number of hours away or distance requirement threshold
- Actually stayed overnight, or
- Stopped to obtain substantial sleep or rest

MEAL ALLOWANCES/REIMBURSEMENTS

Meal Reimbursements While Traveling on Business - cont.

Meals Away From Tax Home But *Not* Overnight

Generally, taxable as a wage to the employee because travel must be away from home overnight to be excludable.

Courts have set very strict rules on what constitutes substantial sleep or rest. See Travel Expense Reimbursements chapter for additional discussion and court cases regarding the "Sleep or Rest" rule.

Example: An employee is required to travel from Eugene to Portland to work for the day. The employer agrees to pay for the employee's meals while in Portland. The employee leaves home at 7:00 a.m. and returns home at 9:00 p.m. Before the employee returns in the evening, the employee takes a nap in his/her car for an hour.

Even though the employee is away from his tax home for substantially longer than a normal work day and even stops for rest, the employee is not considered to be away from home overnight. The rest would not be considered substantial. Any meal money that the employee receives would be taxable as a wage.

Meal Reimbursements While NOT Traveling Away From Home

Pub. 463

Entertainment Meals Reg. §1.274-2(c) and (d)

Reimbursements or allowances provided to employees for meals while entertaining customers may be excludable if the expenses are ordinary and necessary, and meet one of the following tests:

Directly-Related or Associated Entertainment:

Directly-Related Test - Meal reimbursements meet the directly-related test and may be excludable from wages if:

1. The main purpose of the combined business and meal is the active conduct of business,
2. Business is actually conducted during the meal period, and
3. There is more than a general expectation of deriving income or some other specific business benefit at some future time.

All of the facts must be considered, including the nature of the business transacted and the reasons for conducting business during the meal. If the meal takes place in a clear business setting and is for your business or work, the expenses are considered directly related to your business or work.

MEAL ALLOWANCES/REIMBURSEMENTS

Meal Reimbursements While NOT Traveling Away From Home - cont.

Pub. 463

Entertainment Expenses – cont. Reg. §1.274-2(c) and (d)

Examples of Directly-Related Entertainment/Meals

- Meals at a hospitality room sponsored by an employer at a convention.
- Entertainment of civic leaders at the opening of a new City Hall.

Associated Test – Entertainment-related meal reimbursements meet the associated test and are excludable if the entertainment is:

1. Associated with the active conduct of the employer's business, and
2. Directly before or after a substantial business discussion.

Generally, an expense is associated with the active conduct of a business, if there is a clear business reason for incurring the expense. The purpose may be to get new business or to encourage the continuation of an existing relationship. These activities need not occur in a clear business setting.

Whether a business discussion is substantial depends on the facts of each case. A business discussion will not be considered substantial unless you can show that you actively engaged in the discussion, meeting, negotiation, or other business transaction to get income or some other specific business benefit. You must show that the business discussion was substantial in relation to the meal.

Example of Associated Entertainment/Meal

- *Meals officially scheduled as part of a business conference or convention*

Trade or Professional Association Meetings Reg. §1.274-2(d)(3)

Reimbursements for meal expenses directly related to and necessary for attending business meetings or conventions of certain exempt organizations are excludable from wages if the expenses of your attendance are related to your trade or business. These organizations include chambers of commerce, business leagues and trade or professional associations,

MEAL ALLOWANCES/REIMBURSEMENTS

Meal Reimbursements While NOT Traveling Away From Home – cont.

Examples:

(1) Manager regularly buys lunch for all of the employees in her group after monthly group meetings in an effort to boast morale. The manager and the employees are reimbursed by the employer.

This would not be a qualified business meal. The value of the meals would be considered taxable to the manager and to the employees.

(2) A government official attends a Rotary Club meeting as a representative of his agency. The meeting is followed by a dinner for which the official is reimbursed by his agency. Is the meal reimbursement taxable?

The meal reimbursement meets the "associated" with business test, And, therefore, qualifies as an excludable business meal.

De Minimis Exclusion for Occasional Meal Reimbursements

Reg.. §1.132-6(d)(2)

Regularly provided meal money does not qualify for the exclusion for de minimis fringes provided by an employer. Three conditions must be met for treatment of occasional meal money as an excludable de minimis fringe benefit:

- **Occasional Basis** - Meal is reasonable in value, and is not provided regularly or frequently, **and**

- **Provided for Overtime Work** - Overtime work necessitates an extension of the employee's normal work schedule, **and**

- **Enables Overtime Work** - Provided to enable the employee to work overtime. Meals provided on the employer's premises that are consumed during the overtime period, or meal money expended for meals consumed during that period, satisfy this condition.

Meal reimbursements as part of a company policy or union contract may not qualify as an excludable de minimis benefit because the benefit is required and may not be considered occasional. In this case, the employer would have the opportunity to set up the administrative procedures for reporting the benefit.

In no event will meal money calculated on basis of number of hours worked (e.g. $5.00 per hour for each hour worked over 8 hours) be excludable as a de minimis fringe benefit.

MEAL ALLOWANCES/REIMBURSEMENTS

De Minimis Exclusion for Occasional Meal Reimbursements – cont.

Reg.. §1.132-6(d)(2)

Example: Non-taxable de minimis meal benefit

A commuter ferry breaks down and engineers are required to work overtime to make repairs. After working 8 hours, the engineers break for dinner because they will be working for an additional 3 hours. The supervisor gives each employee $5.00 for a meal. The meal is not taxable to the engineers because it was provided to permit them to work overtime in a situation that is not routine.

Example: Taxable de minimis meal benefits

An employer has a policy of reimbursing employees for breakfast or dinner when they are required to work an extra hour before or after their normal work schedule. The reimbursements are taxable because the employer has a policy which indicates payments are routinely made. In addition, the meal reimbursement doesn't enable the employee to work overtime, but is an incentive to do so.

Substantiating Employee Meal Expense Reimbursements

Pub. 463

Meal expense reimbursement/allowance must meet the accountable plan rules in order to be excludable from wages. An employer may reimburse employees using an Actual Expense or Per Diem method.

Reimbursements for allowable business travel meals **while traveling away from home overnight** may be substantiated using either an actual expense method or a per diem method.

Meals **while not traveling**, such as meals with meetings or overtime meals, are substantiated using the actual expense method.

See the chapter on Per Diem and Actual Expense Reimbursements for additional information on substantiation rules.

If an employee chooses not to be reimbursed for expenses, the employee cannot claim the expenses on his/her personal tax return *P.W. Havener, 23 TCM 539*.

EMPLOYEE VEHICLE USED FOR EMPLOYER'S BUSINESS

Background

Employees often use their personal automobiles on company business. An employer's reimbursement of an employee's business automobile expenses is excludable from the employee's income, if it is made under an accountable plan. Otherwise, it is a taxable fringe benefit. An employer can opt to reimburse the employee a mileage allowance in lieu of actual automobile expenses.

This chapter will cover:

- General rules of automobile reimbursements
- Reimbursements at more or less than the federal business mileage rate
- Rules when the employee does not request reimbursement

General Rules for Auto Reimbursements

Rev. Proc. 2002-61
Reg. §1.274-5(g)(2)(iii)
Reg. § 1.274-5

Standard Federal Mileage Rates

January 1, 2004	37.5 cents per mile
January 1, 2003	36.0 cents per mile

Reimbursements for allowable business travel are excludable from the wages of the employee, if made at or less than the standard Federal mileage rate.

Reimbursements for ***non-business travel*** are always taxable even if paid at or below the Federal mileage rate and are to be included in regular wages and subject to all income and employment taxes. Non-business travel is considered personal use.

Personal commuting between the residence and the principal place of business is considered non-business travel or personal use.

Employer Reimbursements in Excess of Federal Mileage Rate

Excess reimbursements over the federal mileage rate are taxable as a regular wages to the employee. When there is an excess reimbursement, both the non-taxable and taxable amounts are **reported** on Form W-2:.

Reimbursements up to Federal Mileage Rate ***(when there are excess Reimbursements)***	*W-2, Box 12 - Code L*
Reimbursements in Excess of Federal Mileage Rate: (Taxable)	*W-2, Box 1, 3, and 5**

**Subject to withholdings in Boxes 2, 4 and 6.*

EMPLOYEE VEHICLE USED FOR EMPLOYER'S BUSINESS

General Rules for Automobile Reimbursements - cont.

Employer Reimbursement Paid At or Less Than Federal Rate
If an employer reimburses an employee's business mileage under an accountable plan, at or below the federal mileage rate, and the employee substantiates the business miles, the reimbursement is:

- Not taxable to the employee, and
- No reporting or withholding required on W-2

Employee Deduction
If an employer reimbursement is less than the Federal rate, the employee can deduct the difference between the federal mileage rate and the employer reimbursement on their individual income tax return, using Schedule A and attaching Form 2106.

Substantiation Requirements
The employee is required to provide substantiation to the employer. Reg. §1.274-5T(c)(1)-(2) Reg. §1.274-5A(f)(3)

Substantiation rules require the employee to record:
- date,
- business purpose, and
- place of each trip.

Record mileage "at or near the time" incurred. Monthly expense reports generally qualify as "at or near the time". Reg. § 1.274-5T(c)(2)(ii)

Rule If Not Requesting Reimbursement From Employer
If employees choose not to be reimbursed for business mileage, they cannot claim the expenses on their personal tax returns. (P.V. Havener, 23 TCM 539)

Example: In 2003, a state agency paid automobile mileage reimbursements of 36 cents per mile to employees for business use of their personal vehicles. The employees verified their expenses on monthly expense reports.

Since the reimbursement does not exceed the federal mileage rate and the business use has been verified, the employees are not taxed for the reimbursements. No reporting is required on Form W-2.

EMPLOYER-PROVIDED VEHICLES

General Rules

Pub. 15-B
Reg. § 1.61-21(c)

Employer Vehicle Used Partly for Business/Partly Personal

- Verified business use is not taxable to the employee
- Personal use is taxable to the employee as wages
- Employer can opt to include all use as wages
- Employee can pay the employer for personal use rather than having it treated as wages

What is Personal Use?

Examples of Taxable Personal Use

***Commuting between residence and work station**, and* vacation, weekend use, or use by spouse or dependents. Reg. §1.162-2(e)

The employee goes into his office on the weekend. This is a personal commute whether or not required by employer .

Examples of De Minimis Non-taxable Personal Use

Small personal detour while on business, such as driving to lunch while out of the office on business.

Infrequent (**not more than one day per month**) commuting in employer vehicle. This does not mean that an employee can receive excludable reimbursements for commuting 12 days a year. The rule is available to cover infrequent, occasional situations. Reg. § 1.132-6(d)(3)

Example: An employee uses a motor pool vehicle for a business meeting. The employer requires that motor pool vehicles be returned at the end of the business day but the employee is delayed and the motor pool is closed when the employee arrives back at the office. The employee takes the vehicle home and returns it the next morning. Is the commute home and back to the office the next morning taxable to the employee?

Assuming that this is an infrequent occurrence for that employee, that is, generally happens no more than once a month, the commuting value of the trip would be considered a non-taxable de minimis fringe benefit. If not an infrequent occurrence, the commute would be taxable to the employee.

EMPLOYER-PROVIDED VEHICLES

General Rules - cont.

Substantiation Requirements IRC 274(d)

Record of business versus personal mileage is required.

If records are not provided by the employee: Reg. §1.132-5(b)
the value of all use of the automobile is wages to the employee, and
the employee can then deduct any business use on Form 1040.

If records are provided by the employee to the employer:
only the personal use of the automobile is wages to the employee.

Exceptions to the recordkeeping requirements apply in certain situations discussed latter in this chapter

Valuing Personal Use of Employer-Provided Vehicle

Reg. §1.162-2(d)

Personal use of an employer's vehicle is a taxable wage to the employee. How do we determine how much to include in wages on the employee's Form W-2?

Step 1: Compute personal use based on miles driven
Example:

2,000 personal miles/10,000 total *miles = 20% Personal use*

Step 2: Apply valuation rule - **General Valuation Rule or**
Special Automobile Valuation Rules

General Valuation Rule

Computation:

1. Determine what employee would pay to lease auto (FMV*).
2. Multiply FMV by % of personal use (computed in Step 1).
   Example: Cost to lease car (FMV) for 1 yr.

plus value of fuel provided	$ 4,000
Multiply by 20% personal use	20%
Include in wage of employee	$ 800

* FMV (fair market value) - the amount an employee would have to pay to a third party in an arms-length transaction. Pub. 15-B Reg. § 1.61-21(b)(4)

EMPLOYER-PROVIDED VEHICLES

Three Special Automobile Valuation Rules

- **Automobile Lease Valuation Rule** Reg. §1.61-21(d)
- **Vehicle Cents-Per-Mile Rule** Reg. §1.61-21(e)
- **Commuting Rule** Reg. §1.61-21(f)

General requirements for using these special valuations:

Employer and employee must timely report personal use as a wage.
Generally, the rules apply on a vehicle-by-vehicle basis.
Employer may use different rules for different vehicles.

Automobile Lease Valuation Rule

Reg. §1.61-21(d)

Computation:

1. Determine FMV* of vehicle on first day made available to employee;
2. Use table in Reg. §1.61-21(d)(iii) or Pub. 15-B to compute Annual Lease Value;
3. Multiply Annual Lease Value by % of personal use computed in ***Step 1;***
4. Value the fuel (if provided) at 5.5¢ per mile or the amount reimbursed to employee for the fuel. (See Reg. §1.61-21(e)(3)(ii)(B) for valuing fuel outside US.)
5. Maintenance and insurance costs are included.

*** Safe-Harbor Valuation** Reg. §1.61-21(d)(5) Pub. 15-B

The employer's cost, including tax, title, etc. may be used to determine the FMV. See regulations for valuing leased vehicles.

Example:
Joe, an employee of Agency XYZ, uses an agency-provided car. In 2002, Joe drives the car 20,000 miles, of which 4,000 were personal miles or 20% (4,000/20,000 = 20%). The FMV of the car is $14,500 for an Annual Lease Value of $4,100. Personal use is valued at $820 ($4,100 x 20%) plus $220 (5.5¢ x 4,000 miles) for fuel costs. $1,040 ($820+$220) is included in Joe's wages.

EMPLOYER-PROVIDED VEHICLES

Automobile Lease Valuation Rule - cont.

Recalculation of Value after 4-Year Lease Term Reg. §1.61-21(d)(2)

Once computed, the Annual Lease Value remains in effect until 12/31 of the 4th full calendar year after the rule is first applied.

Example:
Joe is assigned an agency-provided car on 2/17/99. The agency uses the same $4,100 annual lease valuation until 12/31/03.

After the 4th full year, or if the vehicle is transferred to another employee, the value may be recalculated (unless the purpose of the transfer is only to reduce the tax).

Daily Lease Value Reg. §1.61-21(d)(4)

This method is required if the vehicle is available for less than 30 days.

Fleet Average Value Reg. §1.61-21(d)(5)(v)
Rev. Proc.2002-14

If the employer has 20 or more vehicles (each valued at less than $20,700) used for business and personal by employees, a "fleet-average value" may be used to calculate the Annual Lease Valuation.

Vehicle Cents-Per-Mile Rule

Reg. §1.61-21(e)

Computation

Multiply standard mileage rate by number of personal miles driven. If fuel is not provided, the standard mileage rate can be reduced by up to 5.5 cents. (i.e.: 36 cents – 5.5 cents in 2003)

Example: *Joe drives his agency-provided car for 2,000 personal miles in 2003. The amount included as a wage is $720 (36¢ x 2,000 personal miles or if no fuel is provided it would be $610 (30.5 cents x 2000 miles).*

Requirements

- Vehicle must be regularly used (50% or more each year) in the employer's business, or the
- Vehicle is generally used each workday to transport at least three employees to and from work, in an employer sponsored commuting vehicle pool, or the
- Vehicle is driven by employees at least 10,000 miles per year.

EMPLOYER-PROVIDED VEHICLES

Vehicle Cents-Per-Mile Rule - cont.

Continued Rule Usage

Must continue using the cents-per-mile rule for the vehicle unless the vehicle no longer meets the requirements, except an employer may change to the commuting valuation rule.

Non-Availability Rule Rev. Proc. 2002-14*

Cents-per-mile valuation rule cannot be used for vehicles with FMV exceeding $15,200 (2003)* Note: Amount revised annually. Reg. §1.61-21(e)(1) Reg. 1.280F(d)(7)

Commuting Valuation Rule

Reg.. §1.61-21(f)

Personal use for commuting can be valued at a $1.50 each one-way commute if:

- Vehicle is owned or leased by the employer
- Vehicle is provided to the employee for business use
- Employer requires the employee to commute in the vehicle for a valid non-compensatory business reasons
- Employer has a written policy prohibiting personal use other than commuting
- Employee does not use the vehicle for other than de minimis personal use

If more than one employee commutes in the vehicle, the $1.50 each-way rule applies to each employee.

Key Concepts: The employer must require the employee to use the vehicle for a business purpose; it cannot be voluntary on the employee's part.

Example: A transportation employee, who is on call 24 hours a day to respond to road emergencies, is required by his employer to commute in a vehicle outfitted with communications or other equipment the employee would need if called out at night.

Commuting Rule Not Available for "Control Employee"

Personal use of a vehicle by a "control employee" cannot be valued using the commuting valuation rule ($1.50 rule).

EMPLOYER-PROVIDED VEHICLES

Commuting Valuation Rule - cont.

Governmental "control employee" definition Reg. §1.61-21(f)(6)
Pub. 15-B

A control employee is either an:
Elected official, or an
Employee whose compensation is at least as great as a federal government employee at Executive Level V (2004- $127,300) @www.opm.gov

Instead of the above definition of control employee, the employer may treat all employees who are "highly compensated" as their only control employees. (Generally, $90,000 for 2002 and 2003 – Reg. 1.132-8(f))

Examples:

1) **An agency in a rural area does not have secure parking and has had a history of vandalism to its vehicles. The employer requires employees using the vehicles for the day on business to take the vehicles home overnight. Is the trip home and to the office the next day taxable to the employees?**

   The trip home and to the office the next day is considered taxable personal commuting. The commuting may be valued at $1.50 each way since the employee had a valid noncompensatory business reason for commuting in the employer's vehicle. If this was an unusual situation for the employee, that is, generally occurring no more than once a month, the commuting could be considered a non-taxable de minimis fringe benefit.

2) **An agency requires an employee to take home a van to carry displays and equipment to a trade show the next day. Is the trip home from the office taxable to the employee?**

   In this situation, the commuting could be valued at $1.50 for the trip from the office to home since the agency is requiring the employee to use a specific vehicle for valid business reasons (assuming the other rules of the section are met). If this was an unusual situation for the employee, that is, generally occurring no more than once a month, the commuting could be considered a non-taxable de minimis fringe benefit.

EMPLOYER-PROVIDED VEHICLES

Qualified Non Personal Use Vehicle

Reg. § 1.274-5T(k)

Non-Taxable Usage Reg. § 1.132-5(h)

Use of a qualified nonpersonal-use vehicle, including commuting, is non-taxable to the employee; and record keeping and substantiation by the employee are not required by the IRS.

Definition of Qualified Nonpersonal-UseVehicle: Reg. § 1.274-5T(k)(2)
By design, the vehicle is not likely to have more than minimal personal use: Pub. 15-B

A qualified nonpersonal-use vehicle is any vehicle that the employee is not likely to use more than minimally for personal purposes because of its design. Qualified nonpersonal-use vehicles generally include **all** of the following vehicles.

- Clearly marked police and fire vehicles.
- Unmarked vehicles used by law enforcement officers if the use is officially authorized.
- An ambulance or hearse used for its specific purpose.
- Any vehicle designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds.
- Delivery trucks with seating for the driver only, or the driver plus a folding jump seat.
- A passenger bus with a capacity of at least 20 passengers used for its specific purpose.
- School buses.
- Tractors and other special-purpose farm vehicles.

Qualified Specialized Utility Repair Truck Reg. § 1.274-5T(k)(5)

Truck (not van or pickup) designed to carry tools, equipment, etc. Permanent interior construction, shelves, racks required. Employer must require employee to commute for emergency Call-outs to restore or maintain power services, i.e., gas, water, sewer.

Clearly Marked Police or Fire Vehicles Reg. § 1.274-5T(k)(3)

Marking on a license plate is NOT considered a 'clear mark'.
Employee must always be on call.
Employee must be required by the employer to use the vehicle for commuting.
Employer must prohibit personal use (other than commuting) for travel outside of the officer or fire fighter's jurisdiction.

EMPLOYER-PROVIDED VEHICLES

Qualified Non Personal Use Vehicle -cont.

Unmarked Law Enforcement Vehicles Reg. § 1.274-5T(k)(6)

Employer must officially authorize personal use and the personal use must be for law-enforcement purposes, i.e., no vacation use. The employer must be a governmental unit responsible for prevention or investigation of crime.

The vehicle must be used by a full-time LAW ENFORCEMENT Officer, i.e. officer authorized to carry firearms, execute warrants, make arrests. The officer must regularly carry firearms, except when it is not possible to do so because of the requirements of undercover work.

Vans and Pickups: Rev. Rul. 86-97

DO NOT Qualify unless specifically modified to be unlikely to have more than minimal personal use.

A van or pickup truck with a loaded gross vehicle weight of 14,000 lbs. or less. The vehicle must be clearly marked with permanently affixed decals, special painting, or other advertising associated with your trade, business, or function and: PLR 200236022

Vans – must have a seat for the driver only (or the driver and one other person) and either of the following items.

- Permanent shelving that fills most of the cargo area, or
- An open cargo area and the van always carries merchandise, material, or equipment used in your trade, business, or function.

Pickup Trucks – must meet either of the following requirements:

1. Equipped with **at least one** of the following items.
    a. A hydraulic lift gate.
    b. Permanent tanks or drums.
    c. Permanent side boards or panels that materially raise the level of the sides of the truck bed.
    d. Other heavy equipment (such as an electric generator, welder, boom, or crane used to tow automobiles and other vehicles).
2. It is used primarily to transport a particular type of load (other than over the public highways) in a construction, manufacturing, processing, farming, mining, drilling, timbering, or other similar operation for which it was specially designed or significantly modified.

EMPLOYER-PROVIDED VEHICLES

Safe-Harbor Substantiation Rules for Employer-Provided Vehicles

Reg. §1.132-(5)(e) and (f)

Employees using the following vehicles are not required to keep detailed records of vehicle use, if the employer maintains a written policy restricting personal use or personal use-other than commuting, and meets the specific requirements of the regulations:

Vehicles Not Used for Personal Purposes Reg. **§** 1.274-6T(a)(2)

- Vehicle is owned or leased by the employer
- Vehicle is provided to the employee for use in the employer's business
- When not in use, the vehicle is kept on employer's premises *****
- No employee using the vehicle lives at the employer's business premises
- Employer has a written policy prohibiting personal use unless de minimis such as, driving to lunch while away from the office
- Employer believes the vehicle is not used for any personal use

***** For example**,** motor pool cars

Vehicles Not Used for Personal Purposes Other Than Commuting ($1.50 each way) Reg. **§** 1.274-6T(a)(3)

- Vehicle is owned or leased by the employer
- Vehicle is provided to the employee for business use
- Employer requires the employee to commute in the vehicle for valid business reasons*
- Employer has a written policy prohibiting personal use other than commuting
- Employee does not use the vehicle for personal use

***Key Concept: The employer must require the employee to use the vehicle; it cannot be voluntary on the employee's part.**

Written Policy Statements

Employer must maintain a written policy statement that implements a policy restricting personal use of employer-provided vehicles. The Conference Report to P.L. 99-44, Contemporaneous Recordkeeping Requirements Repeal, states that a resolution of a city council, or a provision of state law, or the state constitution qualifies as a written policy statement for the safe harbor provisions.

EMPLOYER-PROVIDED VEHICLES

Safe-Harbor Substantiation Rules for Employer-Provided Vehicles - cont.

Employer Monitoring Required

Although detailed recordkeeping is not required, the employer has to have some way to prove that the vehicles are being used in accordance with the rules. For example, internal controls such as requiring employees using motor pools to sign out the vehicle, and signed statements by the employees agreeing to no personal use, or no personal use other than commuting.

Examples:

1) **An employer has a motor pool where employees use vehicles on a daily basis, returning them at the end of the day. The employer does not have a written policy concerning personal use of the vehicle. The employees using the vehicles are not required to keep a record of use of the vehicles. Is any of the use taxable to the employee?**

   Yes. The employer does not have a written policy in effect and therefore, does not meet the safe harbor substantiation rules. Since the employees do not keep records of use of the vehicles and the employer does not have a written policy prohibiting personal use, the value of the use is considered a wage.

2) **In Example 1, if the employer maintained a written policy prohibiting personal use of the vehicles and met all the safe harbor conditions of the regulations, would any of the value of the use be taxable as a wage to the employees?**

   No. If safe harbor substantiation rules are in effect, employees are not required to keep records of the use of the qualified vehicles.

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Background

IRC § 132(f)(1)
Reg. § 1.132-9(b)
Pub. 15-A,B & 535

This chapter discusses exclusion rules that apply to benefits an employer provides to his/her employees for the employee's *personal* transportation, such as commuting to and from work..

General Rules

Qualified Transportation Fringe (QTF) benefits are:

- Commuter transportation in a commuter highway vehicle;
- Transit passes; and
- Qualified parking.

Employer-provided QTF's with Fair Market Values (FMV) that do not exceed monthly excludable limits are:

IRC §132(f)(5)
IRS Notice 94-3

- Exempt from withholding and payment of employment taxes,
- Not reported as taxable wages on the employee's W-2, and
- Not reported as gross income.

The exclusion from income applies only to employees.

Regs.§1.132-9(b)

Valuation

Generally valuation is at FMV. Exceptions, if any, are listed under the individual benefit below.

Combined Benefits

The exemption applies whether an employer provides one or a combination of these benefits to employees. The total benefits cannot exceed the statutory dollar limitations, or the excess is taxable as a wage to the employee. Workers may pay for the benefits themselves on a pre-tax basis--see section on Salary Reduction Agreements for the applicable rules.

IRC §132(f)(4)

Cash Reimbursements

Cash reimbursements are allowed as long as the employer establishes a bona fide reimbursement plan. The employee must substantiate the expense.
See Transit Passes for additional requirements.

Reg. §1.132-9(b)
IRC §132(f)(3)

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

General Rules - cont.

Cash Advances

Cash Advances are not considered 'reimbursements'---they are not permitted.

Non-Discrimination Rules

Do *not* apply to QTF's — Reg. §1.132-8
Such benefits are exempt even if provided exclusively to highly-compensated employees.

QTF's and Cafeteria Plans

QTF's are prohibited benefits under Cafeteria Plan Rules. — Reg. §1.132-1(b)(2)(i)
In other words, you cannot include these benefits as part of a Cafeteria Plan.

Definitions

"Month" Calendar month or substantially equivalent period applied consistently.

"**Bona Fide Reimbursement Plan"** Reasonable procedures to verify reimbursements are for QTF's.

"Employee" Includes current employees but only common law employees and other statutory employees and not independent contractors. — Reg §1.132-1(b)(2)(i)

Commuter Vehicle Transportation

Definition

A commuter highway vehicle must: — IRC §132(f)(5), Reg. §1.132-9(b)

- Be provided by, or for, an employer (hiring a third party),
- Be for travel between the employee's residence (or parking lot) and workplace,
- Have seating capacity for at least 6 adults (excluding the driver),
- Have half of it's seating capacity (excluding the driver) occupied by employees,
- Have 80% of the vehicle's mileage be for transporting employees between residences, the workplace and/or parking area.

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Commuter Vehicle Transportation - cont.

Commuter transportation may include vanpools:

Includes the prior commuter highway vehicle rules above, and the vehicles may be owned and operated by transit authorities or employees.

Dollar Limitations

Maximum non-taxable value: $100 per month in 2004, $100 in 2003 (Limited to the combined value of commuter transportation and transit passes per month, i.e.: $100 commuter transp. + $195 parking= $295 total in 2004.)

IRC §132(f)(2) & (6)
Rev.Proc.2001-59

Valuation

Reg. §1.132-9(b), Q&A-21
Reg. §1.61-21(d),(e)&(f)

Automobile lease valuation, vehicle cents-per-mile rule, or commuting valuation rules (discussed in previous chapter) may be used in lieu of FMV. If one of these methods is used, the employer must use the same valuation rule to value the use of the commuter vehicle by each employee who shares the use.

Substantiation Requirements

Only *cash reimbursements* by employers for use of a commuter vehicle need to be substantiated with actual proof of the commuter vehicle use by the employee.

Transit Passes

Pub. 15-B

Definition

Any pass, token, fare card, voucher, or similar item (including an item exchangeable for fare media) entitling a person to transportation**.** Must be used for transportation on public or privately-owned mass transit system, or on transportation provided by a person in the business of transporting people in a vehicle, seating at least six adults, excluding the driver.

Dollar Limitations

Maximum non-taxable value: $100 per month in 2003 (Limited to the combined value of commuter transportation and transit passes per month, i.e.: $100 commuter transp. + $190 parking = $290 in 2003.)

IRC §132(f)(2)&(6)
Rev.Proc.2001-59

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Transit Passes - cont.

Pub. 15-B

Valuation

For transit passes sold at a discount, the discounted price rather than the face amount of the transit pass can be used to figure the exemption as long as the discount is available to the general public. Reg. §1.132-9(b)

Example: A packet of 10 tickets is $15.00 or $1.50 each versus their face value of $17.50 or $1.75 each, the single ticket price available to the public.

Substantiation Requirements

If the employer distributes the transit passes, there are no substantiation requirements. See below for cash reimbursements. Reg. §1.132-9(b)

Cash Reimbursements - Special Rule

Non-taxable only if a voucher or similar item is **NOT** readily available for direct distribution to employees. IRC§ 132(f)(3) Reg. §1.132-9(b)

"Readily available" means it can be obtained:

(1) on terms no less favorable than those available to an individual employee, and

(2) without incurring a significant administrative cost

Qualified Parking

Definition

Parking provided to employees on or near the business work premises, or parking on or near a location from which employees commute to work by commuter highway vehicle, mass transit station, or vanpool. IRC §132(f)(5)(C)

Dollar Limitations

Maximum non-taxable value - $190 per month in 2003. IRC §132(f)(2(B) Rev.Proc.2001-59

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Salary Reduction Agreements

A salary reduction agreement is a way to provide the benefit pre-tax to employees, without additional cost to the employer. An employee can choose between receiving a fixed amount of cash or QTF for a specified future period. A QTF salary reduction plan need not be in writing; but the election by the employee must be in writing or another permanent form, such as electronic.

IRC §132(f)(4)
Regs. §1.132-9 Q&A11-15

The election must contain the following:

- Date of the election,
- Amount of compensation to be reduced, and the
- Period for which the election is valid.

Limitations

The salary reduction may not exceed the combined applicable statutory monthly limits for QTF's, i.e., for the calendar year 2003, the limitation is $290 ($100 + $190).

This election may not be revoked after the employee is currently able to receive the cash or after the beginning the period for which the ATF is to be provided. Any unused QTF may not be refunded. However, the unused portion may be carried over to subsequent periods and used to provide QTF's as long as the amount expended does not exceed statutory limits.

Negative Election

Permitted---if the employee receives adequate notice that a salary reduction will be made and is given adequate opportunity to choose to receive cash compensation instead of the QTF. A negative election means that no response is a YES, --the employee wants the QTF and does NOT want cash.

Effect on Deferred Compensation Plans

IRC §314(e)
IRC §403(b)(3)
IRC §414(s)(2)&(3)
IRC §415(c)(3)
IRC §125

When employees participate in a deferred compensation Plan, they are limited to a percentage of their compensation annually that they may contribute. In **computing** what is considered compensation for purposes of the limitation, an employer may exclude certain fringe benefits. These exclusions did not include QTF's until recently.

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Other Local Transportation Benefits

Three other local transportation fringe benefits allow employers to provide transportation for commuting to employees that is excludable from wages or taxed at $1.50 each way:

- Occasional Cab Fare
- Unusual Circumstances
- Unsafe Conditions

1. Occasional Cab Fare (Local Transportation) IRC §132-6(d)(2)

Local transportation fare provided to **any** employee, regardless of income, is a non-taxable de minimis fringe benefit if it is **reasonable, occasional** and is provided to permit the employee *to work overtime.*

"Occasional" -Infrequent – something that is not regular or routine IRC §132-6(d)(2)(A)

"**Overtime" -**Overtime work necessitates an extension of the employee's normal work schedule IRC §132-6(d)(2)(B)

2. Unusual Circumstances and Unsafe Conditions IRC §132-6(d)(2) (C)(iii)(A)

Local transportation for commuting provided to an employee by an employer because of unusual **and** unsafe conditions is taxable to the employee as a wage at a rate of $1.50 each way. This benefit is not available to control employees.

Unusual Circumstances IRC §132-6(d)(2)(C)(iii)(B)

Examples: Employee temporarily working outside his normal work hours, or an employee temporarily making a shift change

Unsafe Conditions IRC §132-6(d)(2) (C)(iii) (C)

Example: A history of crime in the geographic area surrounding the employee's workplace or residence and the time of day during which the employee must commute.

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Other Local Transportation Benefits - cont.

3. Unsafe Conditions Only

Reg. § 1.61-21(k)

Local transportation for commuting provided to an employee by an employer **solely** because of unsafe conditions is taxable to the employee as a wage at a rate of $1.50 each way. This benefit is available to qualified employees and the employer is required to have a written plan.

Qualified Employee

Only for employees covered by the Fair Labor Standards Act (FLSA) of 1938 **and** with compensation not exceeding specified dollar limitations in IRC § 414(q)(1)(C). Employees covered under the FLSA are not exempt from minimum wage and IRS provisions. See Reg. §1.61-21(k)(6) for details.

Unsafe Conditions

IRC §132-6(d)(2)(iii)(C)

Example: A history of crime in the geographic area surrounding the employee's workplace or residence and the time of day during which the employee must commute.

QUALIFIED TRANSPORTATION FRINGE BENEFITS (QTF)

Examples

(1) Merlin receives transit passes from his employer, State O, with a value of $195 in the month of March 2003 (when the applicable statutory monthly limit is $100 per month). Merlin was hired in January 2003 and has not received any transit passes from the State prior to this. Is this taxable to Merlin?

No, the value of the transit passes (3 months x $100 = $300) is excludable from his wages for income and employment tax purposes. If he were hired in March 2003, only $100 would be excludable from his wages for income and employment tax purposes.

(2) Each month during 2003, the State Health division distributes transit passes with a face amount of $105 to all employees. These same passes can be purchased from the transit system by any individual for $100. Do the State Health division employees have any taxable compensation?

No, since the value doesn't exceed the applicable statutory monthly limit of $100 for 2003, no portion of the transit pass is includible as compensation.

(3) Agency Y maintains a QTF benefit arrangement. Employees of Y are paid twice per month, with the payroll dates being the 10th and 25th day of the month. Employee Q elects, before the first day of the month, to reduce his compensation in return for QTFs totaling $190 through the year 2003. ($190 for qualified parking) Does Q have any tax consequences?

No, since the election was made before he could currently receive the cash and the election is for a specific period, the arrangement satisfies the requirements for a valid salary reduction.

(4) In Example 3, what if employee Q revoked his election on the 10th of the month? Would it be effective for the first or second period?

Second pay period, since the revocation cannot be effective during a current pay period. It must be for a future period.

Examples

***Continued from previous page**:*

(5) Maddy buys a $100 transit pass each month in 2003. At the end of each month, she presents her used transit pass to her employer and certifies that she purchased and used it during the month. The employer reimburses her in the amount of $100. Lulu also purchases a monthly transit pass for $100, but presents it to her employer at the beginning of the month and certifies that she purchased it and will use it during the month. Her employer reimburses her at the time she presents the transit pass. Does Maddy and/or Lulu have taxable income?

In both situations, the employer has established a bona fide reimbursement arrangement for purposes of excluding the $100 reimbursements from the employee's gross income in 2003.

(6) Allison is a qualified employee under the requirements for the commuting valuation rule and works as a data-entry clerk for the Dept. of Revenue in State O. Her normal hours of work are 11 p.m. to 7 a.m. Public transportation, the only means of transportation available to her is considered unsafe by a reasonable person at the time she is required to commute from home to her workplace. DOR hires a car service to pick her up at her home each evening to transport her to work and to return her to home each morning when she finishes her shift. What are the tax consequences, if any, to Allison?

The amount includible in Allison's income is $1.50 for the one-way commute from home to work each evening, because public transportation is considered unsafe at that time of day. However, the value of the commute from work to home each morning is considered includible in Allison's income at FMV since unsafe conditions DO NOT exist for that trip home.

INDEPENDENT CONTRACTOR EXPENSES

General Rules

Pubs. 15, 15-A,463, 535
1099 Instructions
Reg. §1.274-5T(h)

Reimbursements for Travel, Transportation and Other Out of Pocket Expenses

IF SUBSTANTIATED,
Do Not Report on Form 1099 MISC and
Not taxable to the Payee
IF NOT SUBSTANTIATED,
Report on Form 1099-MISC with other compensation
Taxable to Payee--but no withholding required

IRC § 132 (d)

Substantiation Requirements Reg. § 1.132-5(a)

See Working Condition Fringe Benefits Reg. §1.274-5T(h)(2)

Rules for Independent Contractors

Pub 463

Publication 463 provides information regarding accounting for independent contractors (vendors) regarding records, substantiation and reporting requirements.

In general, all compensation for services for an independent contractor are to be reported on Form 1099-MISC when the amount is $600 or more in a calendar year. The amounts are not subject to income or employment tax withholding.

If the individual is considered an independent contractor and they do not properly account to you for their reimbursed expenses, then any advances or reimbursements are to be included on a Form 1099-MISC along with the compensation for their services. Reg. §1.274-5T(h)(2)

Board and Commission Members

Some of the independent contractor rules and reporting requirements may also hold true for board or commission members. Board or commission members may be employees or independent contractors. If you are not sure of the status of a board or commission member, it may be necessary to consult the statutes or ordinances establishing a position to determine whether that position is a public office. In the case of school boards, the statutes or ordinances likely provide ample evidence that the school board members are public officials. Public officials are usually subject to a degree of control that is characteristic of an employer-employee relationship. The IRS has issued a memorandum discussing the employment status of appointed and elected officials. Elected officials should generally be classified as employees while appointed officials may be either employees or independent contractors. See the cited memorandum for a discussion of the issue. ILM 200113024

INDEPENDENT CONTRACTOR EXPENSES

Board and Commission Members – Cont.

Pub. 15-A
IRC § 3401(c)
IRC §3121(d)(2)

Officers, employees and elected officials of states and their political subdivisions and instrumentalities are employees for purposes of federal **income tax** withholding. But for **FICA** purposes, the common-law rules apply to determine whether an individual is an employee.

Employee and Independent Contractor

If a worker is an employee, but is working outside of their regular employment or job duties with the employer, then for that work they could be an independent contractor. For example, an engineer with the public utility district (PUD) also has a janitorial business that he operates out of his home on weekends. The PUD contracts with the engineer to do the janitorial services for the PUD administrative offices.

Misclassification of Workers

Pub. 15-A
IRC §3509

If you classify a worker as an independent contractor and have no reasonable basis for doing so, you may be held liable for employment taxes for that worker. This may be for more than one tax year and could also include the taxes on fringe benefits that should have been provided, i.e.: health insurance, deferred compensation, etc.

Examples

1) **An employee of the Department of Utilities has been approved to also do a consulting project for another state agency. Assuming that the other state agency has <u>not retained the right to control</u> the contractor in the details and means of completing the project, the worker would be considered an independent contractor for the consulting services and an employee for his position with the DOU.**

2) **An independent contractor is hired to perform specific services for a set fee, plus out of pocket expenses. If the contractor provides adequate substantiation for the out of pocket expenses, they will not be reported anywhere, either as income on Form 1099 or on the contractor's individual income tax return. The contractor is not permitted to deduct the expenses if they are reimbursed by the payer.**

ALLOWANCES PAID BY EMPLOYER

General Rule

IRC §162

Ordinary and necessary business expenses paid or reimbursed by an employer on behalf of an employee are excludable to the employee, if payments meet the rules of an accountable plan.

Accountable Plan Key Requirements Reg. §1.62-2(c)(1)

- Business Connection Pub. 535/463
- Substantiation Reg. §1.274-5T
  Elements required for substantiation:
  (1) Amount, (2) Date (Time), (3) Place, (4) Business Purpose Reg. §1.274-5T(b)(2)
- Excess returned within a reasonable time

Under the business connection requirement, the expense would have to qualify as a business expense to the employer and as a deduction on the employee's 1040 as an employee business expense, if the employer did not reimburse the expense.

Work Clothes and Uniform Allowances and Reimbursements

IRC § 162
Reg. §1.62-2(c)(1)

Excluded from wages of an employee, if the clothing or uniforms are:

- Specifically required as a condition of employment, and are
- Not worn or adaptable to general usage as ordinary clothing.

Accountable plan rules must be met.

⇨ **Note:** If the clothing qualifies as excludable, then the cleaning is also excludable.

Safety Equipment

IRC § 162
Reg. §1.62-2(c)(1)

Excludable as a wage to an employee if:

- the equipment helps the employee to perform his/her job in a safer environment.
- The equipment does not have to be required by the employer.
- The accountable plan rules must be met.

Examples: hardhat, anti-glare screen for computer, safety shoes

ALLOWANCES PAID BY EMPLOYER

Mileage Allowances

IRC § 162
Reg. §1.62-2(c)(1)

Excludable as a wage to an employee, if the allowance meets the accountable plan rules:

- Business Connection
- Adequate Accounting/Substantiation
- Return of Excess Amounts

Example: Employer provides employee with a car or mileage allowance and no substantiation is required.

The car allowance is fully taxable as wages to the employee since the business use has not been substantiated. The accountable plan rules have not been met.

Cell Phones /Electronic Devices/Computer

IRC § 274(d)
IRC § 280F(d)(4)
IRC § 132(d)

Employers often provide employees with certain electronic and telecommunication equipment for use outside of the employer's premises in the performance of their duties. These items (and other items listed in IRC § 280F) are considered "listed property". Because the nature of the property lends itself to personal use, strict substantiation requirements are in place. Employees are required to account for business and personal use.

Examples: Cell Phones, Automobiles, Computers, Internet Server Allowances

"Listed Property" IRC § 280F(d)(4)

- Business use is excludable from the wages of the employee as a working condition fringe benefit.
- Personal use is included in the wages of the employee.
- If substantiation requirements are not met, all use is included in the wages of the employee.

Substantiation Requirements IRC § 274(d)

Records of business and personal use must be kept by the employee in order to determine whether the value of any of the use is included in the employee's wages.

Cell Phones /Electronic Devices/Computer - cont.

Substantiation Requirements - cont. IRC § 274(d)

Example: An employer provides an employee with a cell phone and pays the monthly charges. The employer requires the employee to highlight personal calls on the monthly bill. The employer includes the direct charges for personal use and a pro rata share of monthly fees and services in the wages of the employee. The business use is not taxable to the employee.

Examples

(1) Periodic allowance payments to employees for the purchase and maintenance of specific articles of *employer required* uniforms.

The allowances are not taxable to the employees provided the uniforms are not adaptable to general usage, and are, in fact, not worn for general usage. In addition, the employees must substantiate the expenses. If substantiation is not required and provided, the allowance is taxable as a wage to the employees when paid.

(2) Extra premium per working hour for employees who provide their own tools.

Premium pay does not meet the accountable plan rules and, therefore, is additional compensation includible in income and fully taxable as a wage. The employees retain ownership and control of their tools and there is no accountability to the employer. The employees are not required to substantiate the cost of each of their tools. The premium is not specifically related to the employees' expenses. Reimbursements based on the hours worked cannot meet the accountable plan requirements. The employees may be entitled to claim an employee business expense deduction on their personal 1040 tax returns (Form 2106, Schedule A.)

ALLOWANCES PAID BY EMPLOYER

Examples - cont.

(3) Paying employees on an annual basis for part of the cost of safety equipment not required by employer.

The payments may be excludable even though the safety equipment is not required by the employer. If the equipment helps the employee perform *his/her job in a safer environment, it may qualify as an employee business expense. If the expenses are substantiated, the reimbursement would be excludable to the employee.*

(4) Cell phone allowances paid to employees.

Cell phones are considered "listed property" and special substantiation rules apply. Employees are required to keep records of business and personal calls. Reimbursement for <u>personal</u> usage should be included as wages to the employee. If records are not kept of business and personal use, the value of all usage is included in the wages of the employee.

(5) An agency is required to reimburse certain employees for shoes under a union contract. The shoes are not safety shoes.

If the shoes are not safety shoes and are adaptable for general wear, the reimbursements are included as a wage to the employees even though the employer is required to make the payment.

OTHER TYPES OF COMPENSATION

General Information

General Rule

Compensation for services, including fees, bonuses, commissions, taxable fringe benefits, and similar items are taxable as "wages" or regular pay. All income is taxable unless it is specifically excluded by the Internal Revenue Code. IRC § 61

Some types of payments are considered 'supplemental' wages and are subject to specific withholding rules. Supplemental wages are compensation paid in addition to the employee's regular wages.

Types of Taxable Supplemental Compensation Reg. §1.61-2

- Bonuses
- Signing ,Recruiting, or Relocation Bonus
- Awards for outstanding service or performance
- Back pay
- Severance pay - payments to terminate employment
- Amount paid to someone to refrain from working (administrative leave)
- Recognition payments for exceptional work and performance
- Certain legal settlements and/or damages related to employment.
- Grossing up wages to pay for the employee's share of taxes. Reg. § 1.3401(a)-1(b)(6)

"Grossing Up" Wages Rev. Rul. 86-14 Pub. 15-A

If an employer pays the employee's share of payroll taxes without deducting it from the employee's pay, the amounts paid are wages subject to withholding tax. This may result in a "pyramiding". To avoid this, see Rev. Proc. 81-48 which details a formula for grossing up wages. This does not apply to FICA taxes for household and agricultural workers.

Example:

An agency is offering cash incentives for early retirement. John accepts the “early out” option. At the time he retires, he has 28 years of service. He receives his regular pay for the final pay period, a $25,000 bonus for retiring early, plus a cash settlement for accrued vacation pay. All of these payments are taxable as compensation for services and subject to all income and employment taxes withholdings. If the employer pays the related income and employment taxes, those amounts would have to be "grossed up".

OTHER TYPES OF COMPENSATION

Supplemental Wages Concept – Income Tax Withholding Options

Federal Income Tax Withholding On Supplemental Wage Payments. Reg. §31.3402(g)-1 Pub. 15 Circular E

1) If the employer pays the supplemental wage with regular wages and doesn't specify the amount of each, withhold as if the total were a single payment for the regular payroll period.

2) If the employer pays the bonus separately (or combines and specifies the amount of each in a single payment), the withholding method depends on whether the employer withheld income tax on the regular wages:

   a) If withholding was taken, the employer can either withhold at a flat percentage of 25%.

   b) Add the supplemental and regular wages for most recent payroll. Figure the income tax as if the total were a single payment. Subtract the tax already withheld on the regular wages and withhold the remaining income tax amount.

   c) If withholding wasn't taken from the regular wages, use method 'b' above.

   d) Section 10 of the Employer's Supplemental Tax guide provides several alternative methods for figuring withholding.

The employer also has the option to use a method not illustrated as long as the amount of tax withheld is about the same as it would be under the percentage method shown in Circular E. The employer must be sure to test the full range of wage and allowance situations to make sure they meet the tolerances contained in Reg. §1.3402(h)(4)-1. Pub. 15-A

AWARDS AND PRIZES

General Rules For Non-Taxable Awards and Prizes

IRC §74(a)
IRC §3121(a)(20)

Generally, the value of an award or prize given by an employer is taxable to an employee as a wage, included on the W-2, and subject to federal income tax withholding, social security (6.2%) and Medicare (1.45%). An employer's matching contribution is required for social security and Medicare (7.65%), unless the employee has already reached the current calendar year's maximum social security level.

Pub. 525/535
Pub. 15-B

If the employer pays the employee's share of taxes, these amounts are additional wages to the employee (except for agricultural and domestic services) and are subject to all payroll taxes. Rev. Proc. 81-48 provides a formula for determining the amount of "grossed up" wages.

Rev. Rul. 86-14

Three Categories of Non-Taxable Awards

Non-taxable awards are limited to three categories. Each category has specific requirements that have to be met in order to be excludable.

Pub. 525/535
Pub. 15-B

- Certain prizes or awards transferred to charities
- De minimis awards and prizes
- Certain employee achievement awards

Any other awards, such as recognition rewards (unless qualifying de minimis fringe benefits), are taxable. A worksheet to compute the taxability of an award to an employee is provided at the end of this text.

Non-Taxable Prizes or Awards Transferred to Charities

IRC §74(b)

Certain prizes and awards given for charitable, scientific, artistic or educational achievement are not taxable to the recipient if transferred to a charitable organization.

Examples: Nobel Peace Prize and Pulitzer Prize for Journalism

AWARDS AND PRIZES

Non-Taxable Prizes or Awards Transferred to Charities - cont.

Requirements For Non-Taxability

- Award is for past achievement
- Recipient is selected without entering any contest
- No substantial future services are required
- Recipient transfers the award to a charitable (IRC §170(c)) organization prior to receiving the benefit

Example: A college instructor is chosen as teacher of the year by a national education association. He is awarded $1,000 which he directs the education association to transfer to a college scholarship fund at the institution where he teaches before accepting it. The award is not taxable to the college instructor.

Non-Taxable De Minimis Awards and Prizes

IRC §132(e)

A prize or award that is of nominal value and is provided infrequently is excludable from an employees' wages, if it is not cash or a cash equivalent. Prizes or awards that are given frequently to an employee do not qualify as an excludable de minimis award, even if each award is small in value.

Examples of Excludable De Minimis Awards Provided in the Regulations

Nominal gifts for birthdays, holidays
Holiday turkey and hams
Flowers, plaques, coffee mugs for special occasions
Gold watch on retirement
Parking for employee of the month (If value is less than QTFB limit-2003 limit is $190/month; $195/month in 2004)

Definitions

"Nominal" - small in value. There is no set dollar amount in the law for nominal prizes or awards. A $25 limit is imposed on *business gifts.* The IRS has given advice at least once that a benefit of $100 did not qualify as de minimis. ILM 200108042

"Cash equivalent" - An item that can be converted to cash, such as, a savings bond or gift certificate. A gift certificate that is restricted to a limited choice of merchandise is not a "cash equivalent".

AWARDS AND PRIZES

Non-Taxable De Minimis Awards and Prizes - cont.

Cliff Provision Reg. §1.132-6(d)(4)

If an employer provides an award that exceeds either the value or frequency limitations for de minimis fringes, the entire award is included in the employee's wages, not just the portion that exceeds the de minimis limits.

Employee Achievement Awards

IRC §74(c)

General Rules for Employee Achievement Awards Reg. §1.274-8(c)(1)

An employee achievement award is an item of tangible personal property for **length of service or safety.** In order to be excludable from wages, special requirements and dollar limitations must be met.

- **Limited to Length of Service and Safety Awards Only**
- Cannot be a disguised wage
- Must be awarded as part of a meaningful presentation
- Must be an item of tangible personal property Reg. §1.274-8(c)(2)
  (Cannot be cash, cash equivalent, vacations, meals, lodging, theater or sports tickets, stocks, bonds.)
- Must meet other special requirements and limitations

⇨ **Note*:*** Taxable if cash or cash equivalent, or if over certain dollar limits

Length Of Service Awards Reg. §1.274-8(d)(2)

An award will not qualify as a length-of-service award if either of the following applies.

- The employee receives the award during his or her first 5 years of employment.
- The employee received another length-of-service award (other than one of very small value) during the same year or in any of the prior 4 years.
  Exception to 5-year rule: Traditional retirement award

Employee Achievement Awards - cont.

Safety Achievement Awards Reg. § 1.274-8(d)(3)

An award will not qualify as a safety achievement award if either of the following applies.

1. It is given to a manager, administrator, clerical employee, or other professional employee.
2. During the tax year, more than 10% of the employees, excluding those listed in (1), have already received a safety achievement award (other than one of very small value). Eligible employees must have worked full-time for a minimum of one year prior to the award.

Example: If an agency has 50 eligible employees and 6 receive safety awards, the 6th award is taxable because 10% of the eligible employees have already received it.

Taxability of Employee Achievement Awards

IRC § 274(j)(2)
Pub. 535

Generally, if an award is taxable to an employee, it is valued at the fair market value (FMV). The taxable amount of an award to an employee depends on whether the award is made under a qualified or nonqualified plan, whether the cost of the award to the employer exceeds the dollar limitations, and the FMV of the award.

Qualified Plan Award Reg. § 1.274-8(c)(5)

A qualified plan award is an award:

- made under an established written plan , *and*
- does not discriminate in favor of highly paid employees, *and* IRC § 414(q)(1)
- the <u>average cost</u> of <u>all</u> employee achievement awards (both qualified and nonqualified awards for length of service and safety) made by the employer during a single year does not exceed $400. Awards of $50 or less are not included in computing the average. Reg. §1.274-8(c)(5)

Example: *In 2001, an agency presents employee length of service awards to 6 employees for a total cost to the employer of $1,800. The <u>average cost</u> of awards is $300 ($1,800/ 6). Since the average cost of all awards does not exceed $400, the awards are considered qualified plan awards provided there is a written plan that does not discriminate in favor of highly paid employees.*

Taxability of Employee Achievement Awards - cont.

Nonqualified Plan Awards Reg. §1.274-8(c)(5)(ii)

A nonqualified plan award is one ***not*** made under a qualified plan. nonqualified awards can discriminate in favor of highly paid employees.

Dollar Limitation
The maximum amount of excludable awards to a single employee during a calendar year is limited to:

- $400 for awards made under a nonqualified plan, or
- $1600 in total for awards made under both qualified and nonqualified plans

***Example*:** An employee receives 2 employee achievement awards during the year. The cost and FMV of the awards were the same.

	Cost and FMV
Nonqualified plan award of a watch	$ 400
Qualified plan award of a stereo	1,350
Total awards	$1,750
Less: Annual limitation	(1,600)
Taxable portion of awards	$ 150

Cost Exceeds Dollar Limitations - Excess Deduction Award Reg.. §1.74-2(b)

Generally, if an award is taxable to an employee, it is valued at the fair market value (FMV). If the cost to an employer for an award exceeds the plan dollar limitations, either $400 (non-qualified plan) or $1600 (qualified plan), then the employee will be taxed on the ***greater*** of:

1. The part of the employer's cost that is more than the plan dollar limitation (but not more than the FMV), or
2. The amount by which the FMV exceeds the amount of the plan dollar limitation.

Taxability of Employee Achievement Awards - cont.

Cost Exceeds Dollar Limitations - Excess Deduction Award - cont. Reg.. §1.74-2(b)

Example 1: Excess Deduction Award

An employer pays $520 for golf clubs given to an employee as a nonqualified plan employee achievement award. The fair market value of the award (golf clubs) at the time it is given to the employee is $750.

	Cost	FMV
Award	$520	$750
less: Limitation	400	400
Excess over limitation	$120	$350

The employee is taxed on $350, the greater of the FMV over the dollar limitation. If the award had been a qualified plan award, the employee would not have been taxed on any of the value of the award.

Example 2: Excess Deduction Award

An employer pays $395 for golf clubs given to an employee as a nonqualified plan employee achievement award. The fair market value of the clubs at the time it is given to the employee is $450.

	Cost	FMV
Award	$395	$450
less: Limitation	400	400
Excess over limitation	$ 0	$ 50

Since the employer's cost of the award does not exceed the $400 limitation for nonqualified awards, the employee is not taxed on the value of the award.

AWARDS AND PRIZES

Taxable Prizes and Awards

Regardless of the cost of an award or its FMV, the following awards are taxable as a wage to an employee:

- Cash or cash equivalent awards - e.g. savings bonds

- Recognition awards, cash or non-cash, for job performance unless they are qualifying de minimis fringe benefits
  Examples: *Awards for outstanding customer service, employee of the month, highest productivity*

- Achievement awards, cash or non-cash, that don't meet the requirements for excludable treatment
  Examples: *Awards for length of service or safety achievement that do not meet certain specific requirements and limitations.*

- Non-cash prizes (unless de minimis) won by employees from random drawings at employer sponsored events. Reg.. § 1.74-2(c)(4)

Source of Funds Implications

If funds for awards or prizes are provided by an outside party, the award is still taxable to the employee. If the funds are turned over to the employer to select and distribute the awards, the employer is responsible for all applicable payroll taxes and withholding. IRC § 3402(d)

Examples:

A bank provides funds to a state agency to support a special performance award program. The agency chooses the recipients and distributes the awards. The value of the awards are additional compensation to these employees and reportable on their Forms W-2, subject to payroll taxes and withholding. This answer would be the same even if the outside party were a nonprofit organization or an educational foundation.

In the case where the outside party selects and distributes the award directly to an agency employee without any direction or decision making from agency personnel, then the award is income to the recipient and must be reported. The outside party would be required to provide a Form 1099-MISC if the amount is $600 or more in a calendar year.

AWARDS AND PRIZES

Examples

(1) Is a television, donated by a business to a state agency, taxable if the agency awards the television in a random drawing of employees?

Yes. The fair market value of the television would be considered a taxable wage to the employee. Prizes in a random drawing of employees are considered wages. A television is not considered a de minimis benefit.

(2) If an agency pays the taxes on an award, is that payment taxable to the employee?

Yes, the term for this treatment is "grossing up." The additional payment for the taxes is a taxable item and must be included on the employee's W-2 in the year the payment was made. See Rev. Proc. 81-48 and Rev. Rul. 86-14.

(3) If special duck prints donated by artists are given away as awards to employees, how would the agency establish the fair market value (FMV)?

The FMV can be determined by an appraisal, by establishing the sales price of similar prints by the artist, or by any other reasonable method. The taxability of the value of the prints to the employees depends on the type of award, dollar limitations and other specific requirements.

(4) An employer only makes awards to employees that are non-cash qualifying length of service or safety awards. In order to avoid the extensive recordkeeping and tracking required for determining the taxability of awards, the employer has a policy of not making awards that exceed $400 per employee annually. In this situation, are any of the awards made by the employer taxable to the employees?

Assuming that the awards are qualifying length of service or safety awards, none of the awards would be taxable to the employees.

(5) An employer provides dinner at an annual awards banquet for employees. Is the value of the meal taxable to the employees?

No. The regulations specifically mention that occasional group meals are considered a non-taxable fringe benefit Reg.§1.132-6(e)(1)

CHARITABLE CONTRIBUTIONS TO GOVERNMENT ENTITIES

Introduction

Many times citizens make contributions to government agencies. A contribution is deductible only if made to, or for the use of, certain qualified organizations. A State or local government agency is a qualified organization.

This chapter will cover:

General rules for donations made to governments
Substantiation rules, and
Donor information.

Donations to Governments

General Rule

Individuals are allowed to make charitable contributions to certain qualified organizations; i.e.: a state agency. A donor can give a contribution to a State for charitable or public purposes and have a full deduction up to the limitation (50% of adjusted gross income) because a state or government entity is publicly supported and not a private foundation. IRC § 170(a) IRC §170(c)(1)

Government Agency Information

What makes a government agency a "qualified" organization for receipt of donations, grants, etc.?

The Internal Revenue Code lists the types of organizations that are considered to be qualified organizations for purposes of receiving charitable contributions in Publication 557 annually. IRC §170 (c)(1) IRC 170(b)(1)

Most familiar Charitable Organizations are exempt under IRC 501(c)(3).

A governmental unit, i.e.: state or local government is not a 50l(c)(3) organization. A government entity is exempt from income tax by statute (IRC Section 115) and is considered an exempt organization for purposes of receiving donations or grants under IRC Section 170(c)(1). Reg. §1.170A-9(d)

CHARITABLE CONTRIBUTIONS TO GOVERNMENT ENTITIES

Government Agency Information - cont.

Substantiation Requirements

Contributions of $250 or more must be acknowledged in writing by the governmental agency receiving the donation in order for the donor to claim a deduction. IRC §170(f)(8) Reg. §1.170-13

Written acknowledgment to the donor must include:

- Cash received, and a
- Description of property received but not the value, and the
- Value of any goods/services, if any, provided to the donor in exchange for the contribution.

There is no preferred format as long as the acknowledgment is in writing. (Treasury Decision 8690, Dec. 13, 1996)

⇨ **Note:** Do not include the fair market value of any donation in the acknowledgement. Depending on the type of property and the donor's tax situation, different IRS rules apply for property valuation.

Donor Information

A contribution is deductible only if made to or for the use of a qualified organization, and is voluntary and is made without getting or expecting to get anything of equal value. IRC §170 (c)(2)(C) Pub. 526

In order to claim a charitable contribution as a deduction on Schedule A of the 1040 federal tax return, the donor must obtain a written acknowledgement from the qualified organization receiving the contribution if it is $250 or more. Publication 526 provides information on taking a charitable deduction. Reg. § 1.170A-13 (f)(1)

If the employee needs assistance determining the value of donated property, Publication 561 is available. See the "Government Agency Information" section above about the format of the written acknowledgement.

PROFESSIONAL LICENSES AND DUES

Background

An employer may reimburse employees for the cost of their professional licenses and professional organization dues and have it be excludable from wages, when those licenses or professional organization dues are actively enmeshed in the employee's job.

Example: If an employer pays an employee's professional dues to the National Association of Finance Officers (i.e. employee is a finance officer), then that is an excludable reimbursement/payment to the employee as long as the accountable plan rules are met.

This chapter will cover:
General rules for reimbursement for professional licenses
General rules for reimbursement for some organizations dues, and examples of each.

Professional Licenses

General Rules

- Fees paid to maintain a professional license are considered an ordinary business expense. — IRC § 162, Reg. §1.162-6

  Examples: Notary, Engineering, Law, CPA, and other professional licenses

- If paid by an individual, the fees are deductible as a business expense on the individual's federal income tax return. — IRC §162, Reg. §1.62-1T(e)

- If paid or reimbursed by an employer for an employee, the fees are a working condition fringe benefit, and — IRC § 132(a), Reg. §1.132-5(a)(1)(v)

- **If paid** :

  under an accountable plan, it is excludable from the income of the employee; — IRC §62(a)(2)(A), Reg. §1.62-2(c)(2)

  under a non-accountable plan, it is included in the income of the employee and subject to federal income tax, social security, and Medicare taxes. — IRC § 62(c)(1)&(2), Reg. §1.62-2(c)(3)

Employees must comply with recordkeeping requirements — IRC §274

PROFESSIONAL LICENSES AND DUES

Organization/Association Dues

General Rules

Generally, no deduction is allowed for dues paid to any club organized for business, pleasure, recreation, or other social purposes. **But…**there is an exception for professional organizations. An employer may provide an excludable reimbursement to an employee for professional organization dues when the professional organization's focus or mission is directly related to the duties performed by the employee.

IRC §274(a)(3)

Business and Professional Organizations

Clubs organized for business purposes only, such as business leagues, professional organizations, and trade associations, are not considered entertainment or recreational organizations. If related to the employer's business, payment or reimbursement of dues is excludable to the employee when the employee is performing duties for the employer which are related to the professional organization's focus/mission.

Reg. §1.274-2(a)(2)(iii)(b)
Reg. § 1.274-2(b)-2

Examples: Bar and Accounting Associations; AICPA, State Association of CPAs, OASBO; WACUBO or Public Service Organizations.i.e.: Kiwanis and Rotary Clubs

Entertainment and Recreational Organizations

IRC §274(a)(3)

Club dues are a taxable fringe benefit after December 31, 1993.
No business deduction is allowed for club dues.
If an employer pays or reimburses an employee for club dues, the amount is taxable to the employee and subject to income tax withholding, social security and Medicare taxes.

Types of Clubs: Country clubs, yacht clubs, golf clubs, or other social clubs

PROFESSIONAL LICENSES AND DUES

Examples

(1) A state agency requires an employee to be a Notary. The employee submits the paid receipt to the agency and the agency reimburses for the annual fee to maintain this professional license. Is this payment taxable to the employee?

It is not taxable to the employee because it is an ordinary and necessary business expense per IRC Section 162 and paid by the employer under an accountable plan.

(2) **When are employer reimbursements for obtaining professional licenses or license renewals non-taxable for employees?**

Once an employee has completed the education or experience required for a professional license, the expenses necessary to maintain a license or status are considered ordinary and necessary expenses. If the employer pays these expenses (under an accountable plan), it is a non-taxable benefit to the employee, as long as the professional license is related to the position the employee holds with the employer.

(3) A state agency executive receives a social club membership and monthly dues paid by his employer. The value of this fringe benefit has not been included in in his wages because the executive believes the membership and dues are NOT taxable to him because he represents the agency at the various club functions. Is this a taxable fringe benefit to the executive?

Effective December 31, 1993, club dues and memberships are no longer allowed as a business deduction. If an employer provides these benefits to an employee, they are taxable to the employee and subject to federal income tax withholding, social security and Medicare taxes.

(4) A state agency pays the annual CPA license fee for the chief game warden each year. The warden does not use his CPA expertise on the job for the agency. Is this annual reimbursement taxable to the game warden?

Because the game warden does not use his CPA expertise in his game warden capacity with this state agency, the reimbursement to the game warden is a taxable reimbursement to him and is subject to federal income and employment taxes.

STUDENT WAGES - SOCIAL SECURITY/MEDICARE EXCEPTION

General Rules

Rev. Proc. 98-16
IRC § 3121(b)(10)
Rev. Rul. 78-17
PLR 93-32005

Services performed by students are excepted (exempt) from social security and Medicare if all of the following rules are met:

- Services are performed for a school, college, university or IRC § 509(a)(3) affiliated organization, and the
- Student is enrolled and regularly attending classes at the school, college, or university for whom the services are performed, and the
- Services are incidental to, and for the purpose of, pursuing a course of study (worker must be a student, not a career employee), and
- Students are NOT covered under a Section 218 agreement.

The amount of compensation for services performed by the employee, the type of services performed, and the place where the services are performed are irrelevant.

Students Qualifying for Social Security/Medicare Exception

Whose Wages Qualify for Exception?

Rev. Proc. 98-16

Secondary school students, undergraduate and graduate students, whether full or part-time, as long as a student is "regularly" attending classes. There is no precise number of credit hours that determine whether a student is regularly attending classes. Two variables are involved in the determination: number of credit hours and number of employment hours.

See PLR 93-32005 and Rev. Rul. 78-17 for guidelines on qualifying hours.

Examples: Exempt Services

(1) Full-time high school student working during the school year in the kitchen of the school he attends.

(2) Full-time high school student paid to do repair work during the school year at another school in the district. If the employer is the same at both schools, the services qualify as exempt.

(3) Part-time undergraduate student enrolled for 12 credit hours and working in the university library 20 hours per week

Rev. Rul. 78-17

STUDENT WAGES - SOCIAL SECURITY/MEDICARE EXCEPTION

Students *Not* Qualifying For Social Security/Medicare Exception

Whose Wages Do Not Qualify for Exception? Rev. Proc. 98-16

Postdoctoral students or fellows, students covered under Section 218 of the Social Security Act and, generally, medical residents, medical interns, and career employees.

"Career employee" - an individual performing services for an institution of higher education who is:

- eligible to participate in retirement plans, or
- eligible to receive certain elective deferrals, or
- eligible for certain tuition reductions (other than qualified tuition reductions), or
- classified by the institution as a career employee

School Breaks

Exemption from social security/Medicare taxes does not apply to services of student employees not enrolled in classes during school breaks of more than five weeks (including summer breaks of more than five weeks).

Examples: Non-Exempt Services

(1) College student majoring in avionics and interning at a municipal airport to gain experience during the Christmas break. The institution where the student is enrolled is not the employer.

(2) Full-time employee of a university enrolled in a three-credit-hour graduate course who will be eligible to participate in the university's retirement plan after being employed for six months. Even though not yet eligible to participate in the retirement plan, the employee will be eligible once service requirements are met and, therefore, he/she is considered a career employee.

Income Tax Reporting

Payments to student employees performing services exempt from social security and Medicare taxes are still subject to income tax withholding and reporting on Forms W-2.

VOLUNTEERS

Background

Volunteers occasionally assist governmental entities and the entities may, in turn, provide the volunteers with various reimbursements, stipends, or other payments. The treatment of the payments for federal payroll purposes depends on whether the volunteer is an employee or non-employee and what the types of payments are.

When Is A Volunteer An Employee?

IRC § 3121(d)(2)

Right To Control Pub. 1779

A volunteer is an employee if an entity has the right to direct and control the volunteer's performance, not only as to the results to be accomplished, but also as to the methods by which the results are accomplished. It is the "right" to control, even if the entity doesn't exercise the right, that is important. Many factors in an employment relationship have to be considered before a decision can be made as to whether the entity has the right to direct and control.

If an entity does not retain the right to direct and control the details and means of performing the work, the volunteer worker is not an employee.

Evidence Of The Right To Control

In determining whether an entity retains the right to control a worker, the IRS, generally looks at facts that fall into three main categories of evidence: behavioral control; financial control; and relationship of the parties. The facts considered in these categories include whether the agency provides training or instructions, whether the worker can earn a profit or incur a loss, whether benefits are provided and other factors. Not every evidential factor applies in every situation and the degree of importance varies depending on circumstances.

Example - Right to direct and control the results only - Non-Employee

An agency is required to build a watershed in a state forest. Volunteers who are experienced in forestry work have offered their services. The agency asks the volunteers to build the watershed in accordance with environmental laws to the best of their abilities and experience. The agency does not provide other instructions or supervision.

When Is A Volunteer An Employee? - cont.

Example - Right to direct and control the results and methods - Employee

An agency is required to build a watershed in a state forest. Volunteers who are experienced in forestry work have offered their services. The agency asks the volunteers to build the watershed in accordance with environmental laws and provides an agency employee to oversee the project. The agency gives instructions, provides the tools and materials, and sets the hours of operation.

Issues with Volunteers

"Volunteer" Firefighters Pub. 963
ILM 200322002

Generally, "volunteer" firefighters are employees of the fire department or district for which they perform services. The usual common-law tests apply to determine their employment status. For example, the relationship between the firefighter and the fire department will generally indicate that the department provides training and direction in how the work will be performed and provides the equipment to perform the work.

Payments to these firefighters who are employees under the common-law tests are treated the same as payments to other government employees. There is no rule exempting "de minimis" payments from taxes. For instance, volunteer firefighters may not receive salaries, but they may receive amounts intended to reimburse them for expenses. They may also receive other cash or in-kind benefits that may be wages. Volunteer firefighters can receive reimbursements for their expenses, but these reimbursements must be under an accountable plan within the meaning of IRC section 62(c) and regulations in order to be excludable from wages

Property Tax Abatements or Exemptions

Property tax abatements in exchange for volunteer services by senior citizens and emergency responders have been ruled to be taxable income by the IRS. FSA200132035
ILM 200302045

VOLUNTEERS

Tax and Reporting Treatment

Volunteer as Employee

- Stipends and other payments for services are wages.
- Reimbursements paid under an accountable plan are not taxable and not reportable.
- Reimbursements **not** paid under an accountable plan are taxable and reportable on Form W-2 as a wage subject to withholding.*
- Wages in the form of stipends, taxable reimbursements, or other payments are subject to withholding* and reportable on Form W-2.

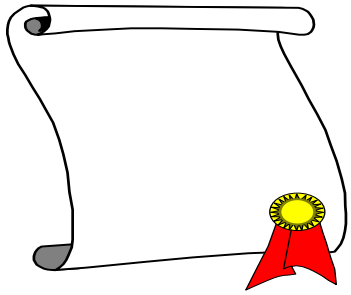
* Unless the wages are not normally subject to social security or Medicare taxes under Section 218 of the Social Security Act.

Volunteer as Non-Employee

- Stipends, taxable reimbursements and other payments for services are reportable on Form 1099-MISC, if payments for the year total $600 or more.
- Substantiated working condition fringe benefit reimbursements are not taxable and are not reportable on Forms W-2 or 1099. Reg. §1.274-5T(h)(2)
- Unsubstantiated working condition fringe benefits are taxable and reportable on Form 1099, if payments for the year total $600 or more. No withholding is required by the paying entity.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Background



An employer may pay or reimburse an employee for an education course. Whether or not the cost or value of the course is excludable from wages to the employee depends on various factors. There are a number of sections of the Internal Revenue Code (IRC) that permit the payments or reimbursements to be excludable from wages providing the requirements in the Code sections are met.

An educational payment that is not exempt from tax under one Code section may be exempt under a different Code section. Excludable treatment of an educational benefit under IRC §132(d) (working condition fringe benefit) applies only if benefits under all other code sections do not apply. A comparative chart at the end of this chapter will help in determining whether specific payments or reimbursements for education expenses are excludable.

Internal Revenue Code Sections:

For all employers:

Working Condition Fringe - Educational Reimbursements	IRC §132(d), Reg. §1.162-5
Qualified Educational Assistance Program	IRC §127

For certain other employers:

Qualified Tuition Reductions	IRC §117(d)
Tuition Waivers for State Employees	IRC §§117(d), 127, 132(d)
Scholarships and Fellowships	IRC §117

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Working Condition Fringe - Educational Reimbursements

IRC §132(d)
Reg. § 1.162-5

Job-related educational expenses are excluded from an employee's income as a "working condition" fringe benefit. This is an excludable benefit of property or service provided by an employer to an employee that, if the employee had paid for it, the employee could have deducted as an unreimbursed employee business expense (IRC §162) on form 1040. The exclusion is, generally available for any form of educational instruction or training that improves or develops the job-related capabilities of an employee.

Reimbursements for education expenses will qualify as a non-taxable working condition fringe benefit, if the following rules are met:

General Rules

- Educational courses must be job-related — IRC §132(d)
- No written plan is required — Reg. §1.132-1(f)(1)
- May discriminate in favor of highly-compensated employees
- No dollar limitation

Requirements for Excludable Treatment

Educational course must: — IRC §132(d)

- Be job-related, and either — Reg. §1.162-5(a)(1)
- Maintain or improve job skills, or
- Be required by the employer or by law.

Educational course must not:

- Be needed to meet the minimum educational requirements of the current job, or — Reg. §1.162-5(b)(2)
- Qualify the employee for a new trade or business — Reg. §1.162-5(b)(3)

Substantiation Requirements of Cash Payments to Employees

Reg. §1.132-5(a)(v)

If an employee receives cash, the employer must require the employee to:

- Use the amount for payment of education expenses that qualify as a working condition fringe benefit,
- Verify that the payment was actually used for such expenses, and
- Return to the employer any unused portion of the payment.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Working Condition Fringe - Educational Reimbursements - cont.

"Employee" For Purposes Of Working Condition Fringe Benefits Only

Regs. . §1.132-1(2)

- Current employees
- Independent Contractors
- Directors and Partners
- Volunteers Regs. . §1.132-5(r)

Qualifying Educational Expenses

- Tuition, books, supplies, equipment Reg. §1.162-6
- Certain travel and transportation costs Reg. §1.162-5(d)
- Graduate or undergraduate level courses Reg. §1.162-5(a)

Courses Required by Employer or Law

- Requirement must be expressly stated by employer (or by state law or regulations);

Examples of court decisions of qualifying (excludable) courses:
Masters Degree required to be obtained in five years or employee is fired; or salary is lower without a Masters Degree

Courses Qualifying Employee for New Trade or Business Reg. § 1.162-5(b)(3)

Generally, education courses that qualify an employee for a new position or specialty within his/her existing trade or business are not considered taxable courses qualifying an employee for a new trade or business. Examples of excludable courses that qualify employees for a new position rather than a new trade or business include:

- elementary school teacher to principal
- elementary school teacher to physics teacher
- manager obtaining M.B.A.

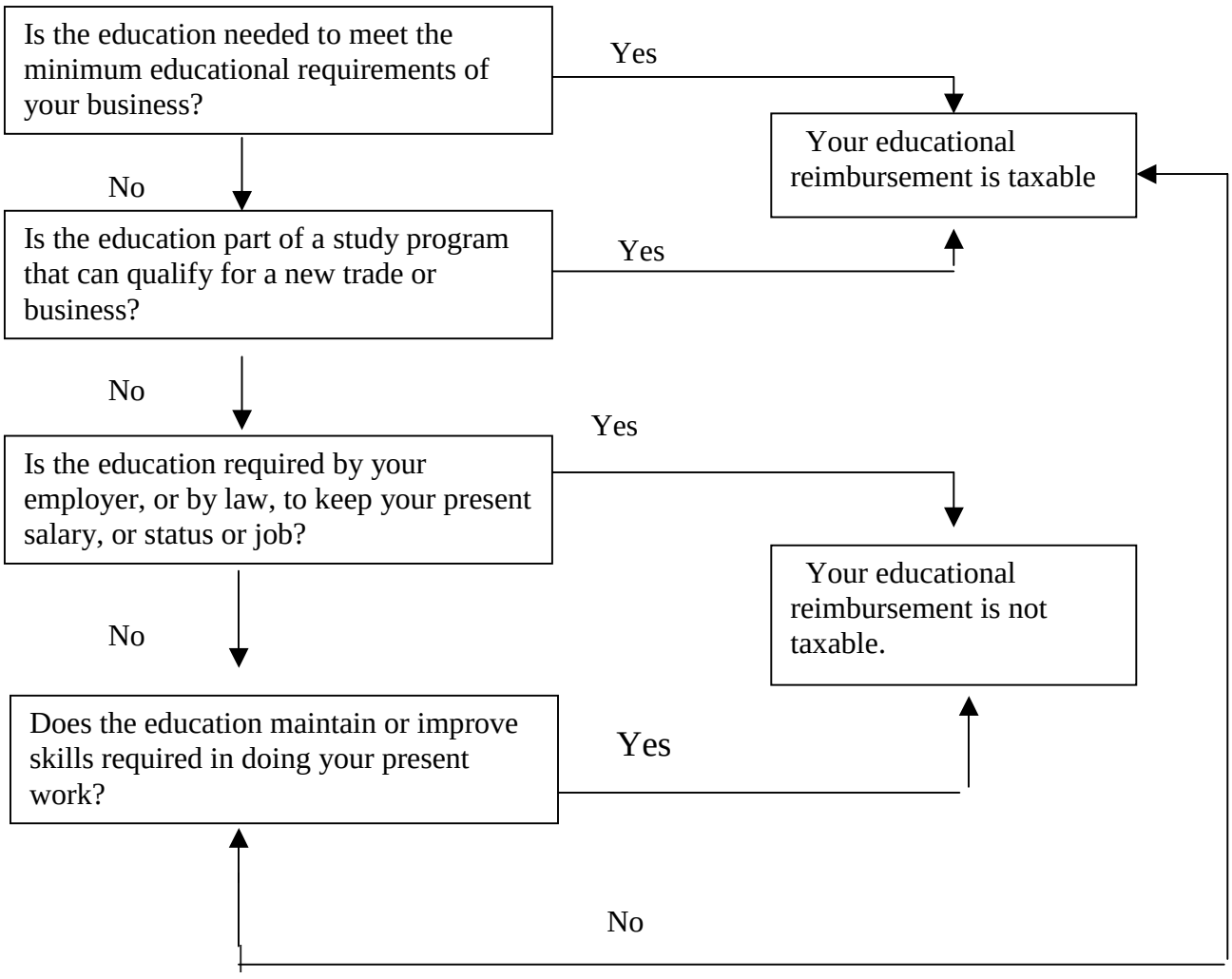
Often, courses needed for acquiring a license or certificate, are considered taxable courses leading to a new trade or business. Examples are:

- Accountant to CPA
- CPA to Lawyer

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Working Condition Fringe - Educational Reimbursements - cont.

Quick Flowchart



EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Examples: Working Condition Educational Fringe Benefit

(1) Veronica is a computer processor at a state agency. She wants to take a graduate computer course at STU University to enhance her current job skills. Will Veronica have any taxable consequences from taking the class?

No, the class is excludable as a working condition fringe because it is job-related and maintains or improves Veronica's skills, and it doesn't prepare her for a new trade or business.

(2) Due to a teacher shortage, Doug, who has 80 hours of college credits, is given a position as a teacher although the job requirements are for 120 hours of credits. Doug is reimbursed by his employer to complete the 40 credits at night school while he is teaching. Is the reimbursement taxable?

Yes, the reimbursement for earning the 40 credit hours is taxable to Doug since the courses are needed to meet the minimum requirements of his present job. (This may be excludable under one of the other Code sections, i.e.: Section 127, see the next section.)

(3) Peter, a fiscal tech hired into an Accountant I position, doesn't have all of the accounting credits he needs for the job. He signs up and takes all of the courses required for the position. The courses will improve his job, but the primary purpose of taking them is to acquire the minimum requirements for the position. Is this taxable to Peter?

The reimbursement for Peter's classes under IRC Section 132(d) is taxable to him because the education is needed to meet the minimum educational requirements of his position. (This may be excludable under one of the other Code sections, i.e.: Section 127, see the next section.)

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Qualified Educational Assistance Programs

IRC §127

General Rules

Amounts paid or expenses incurred by an employer for educational assistance for an employee are excludable from the wages of the employee, if certain requirements are met.

Excludable (Non-Taxable) Requirements:

- Employer must have a written plan — Rev Notice 97-60
- May be for undergraduate or graduate level courses — IRC §127(c)(1)
- Dollar limitation of $5,250 per calendar year — IRC §127(a)(2)
- May be either ***job or non job related*** educational assistance — PL 95-600
- Must not discriminate in favor of highly compensated employees (earning $90,000 or more) — IRC §127(b)(2), Notice 2001-84

Courses Deemed Starting Date

The first regular day of class for any course offered during a regular academic term at an educational institution will be the first day regular classes *generally begin for courses offered that term.*

Definitions

Eligible Employees — Reg. §1.127-2(h)

Current and/or laid off employees, employees retired or on disability, and certain self-employed individuals.
Does not include spouses or dependents of employees.

Educational Expenses — IRC §127(c)(1)

Covers:

Tuition, books, supplies, equipment necessary for class

Does not cover:

Tools or supplies which employee may keep after the course is completed.
Education involving sports, games, hobbies unless job related,
Meals, lodging, or transportation

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Examples: Qualified Educational Assistance Program

(1) Karen is a secretary at a state agency. She wishes to take an undergraduate psychology class at MNO Community College. The state agency has a written educational assistance plan. The state agency pays $250 for the tuition to the community college for the course. What are the tax effects?

Karen has no taxable income because the requirements for an educational assistance plan have been met under IRC §127.

(2) Joe, a janitor at a state agency, wants to take a math class leading towards his bachelor degree. The state agency has a qualified educational assistance plan and reimburses Joe $300 for the course after he verifies the cost. What are the tax consequences to Joe?

Joe does not have taxable wages from this reimbursement. The fact that he is taking a course leading toward an undergraduate degree is not relevant for qualified educational assistance programs under IRC Section 127.

(3) Tom is a recreation specialist for the Division of Parks and Recreation. His employer pays for him to take courses toward a license as a soccer referee. Does Tom have taxable income?

Assuming the employer has a qualified plan, Tom does not have taxable income even though the courses he is taking are sports-related. The courses have a reasonable relationship to the business of the employer and this provides an exception to the rule that sports, games and hobby classes are not permitted under educational assistance programs.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Qualified Tuition Reduction - IRC §117(d)

General Rule IRC§117(d)(1)

Free or reduced tuition for employees of educational institutions may be excludable to the employees.

Requirements To Be Excludable (Non-Taxable): IRC§117(d)(1),(2),(3)

- Employee of educational institution
- Employee is involved in educational function
- Available to employees on a non-discriminatory basis
- Education must be below graduate level***** and

⇨ ***Note:** If employee is a graduate student performing teaching or research activities for the educational institution, he/she may take excludable graduate courses. The courses must be taken at the school where the employee is working. IRC§117(d)(5)[4] IRC 170(b)(1)(A)(ii)

Definitions

"Employee" for Qualified Tuition Reduction:

- Current employee or spouse IRC § 117(d)(2)(A)
- Former employee retired or left on disability IRC § 132(h)
- Spouse, widow or widower of deceased employee
- Spouse, widow or widower of employee retired or left on disability
- Dependent child of employee
- Child (under the age of 25) of employee, where both parents are deceased

Educational Organization: IRC§170(b)(1)(A)(ii)

- Maintains a faculty and curriculum, and
- Normally has a regularly enrolled student body on site.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Qualified Tuition Reduction - IRC §117(d) - cont.

Non Discrimination Restriction:

Generally, an employer cannot discriminate in favor of employees earning $90,000 or more annually. IRC 414(q)(1)(B)(i) Reg. §1.132-8(f)

IR-2002-111(01-2003)

Qualified Tuition Reductions and Code Section 132: Reg. § 1.132-1(f)(1)

If the tax treatment of an educational expense is expressly provided for in a specific Code section, then the fringe benefit Code Section IRC 132 cannot be used. [Except for 132(e)-de minimis fringe benefits] Because section 117(d) applies specifically to tuition reductions, the exclusions under section 132, such as no-additional-cost benefits, or working condition fringe benefits do not apply to free or discounted tuition provided to employees of an educational institution.

Of course, if the amounts PAID by the employer for education relating to the employee's trade or business as an employee of the employer (in other words, there is no tuition reduction or free classes) so that, if the employee had paid for the education, the amount paid could be deducted on their 1040, the costs of the education may be eligible for exclusion as a working condition fringe under 132. FSA 200231016 (13 Mar 2002)

Examples: Qualified Tuition Reductions

(1) Carl works for ABC Community College, a division of the State University, as a physics teacher. His two children attend the State University undergraduate program at a reduced tuition. What are the tax consequences?

This situation meets the requirements for qualified tuition reduction and Carl has no taxable income.

(2) Same facts as in Example 1, but in addition to reduced tuition, Carl's children are receiving free room and board. Does this change the taxation of the benefits?

The tuition reduction is still not taxable but the value of the free room and board will be taxed as a wage to Carl.

Examples: Qualified Tuition Reductions – Cont.

(3) Marie is a research graduate assistant at DOE University. She wants to take an advanced graduate microbiology course at GHI University. There are vacant seats in the class and GHI University will let Maria take the course at no charge. Will Maria have any taxable income?

The class would not be excludable under IRC § 117(d) as a qualified tuition reduction because employees who are graduate students performing teaching or research are required to take courses at the educational institution where they are performing the services in order to qualify for non-taxable tuition reduction. See IRC §117(d)(5)[4].

Because Section 117(d) specifically applies to tuition reductions, the exclusions under section 132, such as no-additional-cost benefit, or working condition fringes do not apply to free or discounted tuition provided to employees of an educational institution.

Tuition Waiver for State Employees

IRC 117(d),127, and 132(d)

State Law

Certain states' laws permit state colleges and universities to waive all or a portion of tuition, services and activities fees for state employees employed half-time or more in the following classifications for permanent employees:

- Classified and exempt paraprofessional employees of technical colleges,
- Faculty, counselors, librarians, and exempt professional and administrative employees at institutions of higher education.

Determination of Taxability/Non-Taxability

Three Code sections may provide relief from taxation for tuition waivers. In order to be excludable, the course must qualify under one of the following code sections:

- IRC §117(d), Qualified Tuition Reduction,
- IRC §127, Educational Assistance, or
- IRC §132(d), Working Condition Fringe.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Tuition Waiver for State Employees - cont.

First Determination Step

Does the employee work for a state educational institution? If so, look at IRC §117(d).

- A *qualified* tuition reduction for employee will be excludable
- Employee must be involved in the educational function
- "Employee" includes employee's dependent children and others
- No dollar limit and No written plan required
- Cannot discriminate in favor of Highly Compensated Employees
- Teaching and research assistants may have qualified excludable reductions on graduate courses taken at their employer's educational institution only
- Employee may attend *any* state educational institution undergraduate class except: teaching and research assistants must take their graduate courses at their employer's educational institution.

Second Determination Step

If the employee works at a state agency other than educational institutions, see §127.

- Look to this Code section for possible excludable treatment
- Employer paid educational assistance not taxable up to $5,250 limit
- Employer must have written plan that satisfies §127
- Graduate or Undergraduate Level Courses qualify
- Employee definition – customary meaning, not expanded like §117(d)
- Ca Reg. §1.162-2(d)nnot discriminate in favor of highly compensated employees

Third Determination Step

If §127 doesn't provide relief, look at §132(d):

- If courses are job related, they could be considered a Working Condition Fringe benefit (Defined as property or services provided to an employee of the employer to the extent that, if the employee paid for it, such payment would be allowable as a deduction on the employee's income tax return). Tuition Reductions (IRC §117) do not qualify under IRC§132(d)
- Qualifying education would be classes that maintained or improved skills
- Non-qualifying taxable education would include classes to meet minimum requirements of job or qualify the employee for a new occupation
- Graduate level courses may qualify as excludable
- No dollar limit and no written plan necessary
- Employer may discriminate in favor of highly compensated employees

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Scholarships and Fellowships

IRC §117

General Rule

Individuals pursuing a course of study or research often receive awards or funds to pay for their educational costs in the form of scholarships, fellowships, stipends, or grants. Regardless of the name given the fund or award, the taxability depends on whether the provisions of IRC § 117 are met.

Non-Taxable if: IRC §117(a)

- Amount is a "qualified" scholarship, and the
- Recipient is a candidate for degree at a qualified educational organization

Taxable if:

- Payment is for past, present or future services, OR
- Payments fund study or research primarily for benefit of the grantor.

Definitions

"Qualified" Scholarship or Fellowship IRC §117(b)(1)

Scholarship or fellowship to the extent the amounts are used for qualified tuition and related expenses

Qualified Tuition and Related Expenses

Includes fees, books, supplies, and equipment required for a class. Does not include travel, meals or lodging. IRC §117(b)(2)

Candidate for Degree Reg. §1.117-6(b)(4)

- Primary or secondary school student, or
- Undergraduate or graduate student pursuing studies or conducting research towards a degree at a college or university
- Non-degree candidate if a full or part-time student at an accredited educational institution

Example: A data processing student at a technical school which is accredited and authorized by the state to provide the program is considered a candidate for a degree for scholarship purposes.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

Scholarships and Fellowships - cont.

Educational Institution

- Educational organization which maintains a regular faculty and curriculum, and — IRC §170(b)(1)(A)(ii)
- Has a regularly enrolled body of students on site.

Taxable Scholarships and Fellowships if: — IRC §117(c)

- Payments fund study and research for benefit of grantor, or
- Compensation is for past, present or future services.

No services can be required of the student in order to receive the scholarship or grant either presently or in the future to be non-taxable.

Example: Jeff, a professor of anthropology at Veritas College, is awarded a fellowship by the college which allows him to devote 100% of his time to a research project of his own choice. The fellowship is designed to award faculty for present or past services. The fellowship is a taxable wage to Jeff.

Example: Tracy is granted a stipend by the city of Portsworth to attend a paramedic training program. She is required to accept employment with the grantor at the conclusion of the training. The stipend is taxable as a wage to Tracy.

Example: Mona is an advanced medical degree candidate at Hospital University. She receives a fellowship grant of $1,000 per month for performing surgery in a residency program at the university's hospital and a one-time payment of $1,500 for independent research. The $1,500 for research is excludable from income . The $1,000 grant to perform surgery represents payment for services and is taxable as wages.

EDUCATIONAL REIMBURSEMENTS/ALLOWANCES

IRS Comparative Regulations Regarding Educational Assistance

Description	§127	§132(d)	§117(d)
Qualified Educational Assistance	**X**		
Working Condition Fringe		**X**	
Qualified Tuition Reimbursement for Employees of Educational Institutions			**X**
Written Plan Required	Yes	No	No
Undergraduate Courses Covered	Yes	Yes	Yes
Graduate Courses Covered	Yes	Yes	No*
Must Be Job Related	No	Yes	No
Courses Qualifying Employee for New Trade or Business Covered	Yes	No	Yes
Courses Needed to Meet Minimum Job Requirements Covered	Yes	No	Yes
Can Discriminate in Favor of HCE's***	No	Yes	No
Dollar Limitation	Yes-$5250	No	No
Expiration date	None	None	None
Employee Includes:			
Current Employees	Yes	Yes	Yes
Family Members	No	No	Yes
Laid Off Employees	Yes	No	No
Employees Retired or on Disability	Yes	No	Yes
Independent Contractors	No	Yes	No
Educational Expenses Covered:			
Tuition, Books, Supplies, Equipment	Yes	Yes	Tuition Only
Tools or Supplies (non capital)	No*	No	No
Education Involving Sports, Games, Hobbies	No**	No**	Yes
Meals, Lodging or Transportation	No	Yes	No

* See text for exceptions
** Yes, if specifically job related
*** Highly Compensated Employees

⇨ **Note:** These are general rules. For details, refer to the text.

FRINGE BENEFITS RESOURCES LIST

Federal Per Diem Rates

Federal rates can be found in the current IRS Publication 1542 or on the Internet at the following addresses:
General Services Administration – Per Diem Rates
http://policyworks.gov/org/main/mt/homepage/mtt/perdiem/travel.shtml
For High Cost Locations – Non Continental USA and Foreign Locations:
http://www.state.gov/www/perdiems/index.html – U.S. Secretary of State – Per Diem Rates

Office of Federal, State and Local Governments (FSLG)

Director, Andrew Zuckerman
Pacific Coast Area Manager - Cheryl J. Powers (925)279-4012 x203
FSLG Specialists - Sue Ann Jansen, sue.jansen@irs.gov
Marilee Basaraba, marilee.basaraba@irs.gov
Customer Account Services - (877)829-5500 (for governmental entities)
Assistance with determination letters, deposits, 941s, penalties

Other IRS Contacts

IRS Taxpayer Information - (800)829-1040
IRS Taxpayer Information (TDD) - (800)829-4059
IRS Taxpayer Advocate - (877)777-4778
(For assistance with long-standing tax issues)
IRS Forms Ordering - (800)829-3676
IRS Forms Ordering (TDD) - (800)829-4059
Fax Ordering - (703)368-9694
IRS Information Returns (W-2, 1099) Assistance
Toll Free (866)455-7438 (8:30 am - 4:30 pm Eastern Time)
E-mail your inquiries to: mccirp@irs.gov
Foreign Tax Questions - (215)516-2000 (6:00 am – 2:00 am EST) (Not toll free)

Internet

http://www.irs.gov/govts - Read Quarterly FSLG Newsletter or sign up to receive
http://www.fedworld.gov/ Fedworld Information Network
(Good for searching, locating, ordering and acquiring government and business information)

Social Security Administration

Tim Beard, Seattle (206)615-2125, FAX (206)615-2643

State Social Security Administrator

Oregon State - Steve Delaney (503)603-7694

FRINGE BENEFITS RESOURCES LIST

Legend for Reading the Citations in the Handout

CITATION SOURCE	EXAMPLES USED IN CLASS HANDOUTS
IRS Code	IRC §132(a)(1)
US Treasury Regulations	Reg. §1.162-2(a)(2)
IRS Revenue Procedures	Rev. Proc. 97-97
IRS Publications	Pub. 15-B
IRS Revenue Rulings	Rev. Rul. 97-97
IRS Notice	Notice 98-03
IRS Announcements	Annc. 85-113
Internal Letter Memorandum	ILM 200113024
Field Service Advice	FSA 200132035

FRINGE BENEFITS RESOURCES LIST

IRS Publications Used in Course

PUB #	TITLE
15	**Circular E, Employer's Tax Guide**
15-A	**Employer's Supplemental Tax Guide**
15-B	**Employer's Tax Guide to Fringe Benefits**
463	**Travel, Entertainment, Gift, and Car Expense**
508	**Educational Expenses**
520	**Scholarships and Fellowships**
521	**Moving Expenses**
525	**Taxable and Nontaxable Income**
526	**Charitable Contributions**
535	**Business Expenses**
970	**Tax Benefits for Higher Education**
1542	**Per Diem Rates**

*New publications are generally available after the first of the year.

Order IRS forms and publications by calling 1-800-829-3676

OR

Download forms and publications at our website: www.irs.gov

AWARDS COMPUTATION WORKSHEET

Employee Achievement Awards
Worksheet for Computing Taxability Per Employee

1. Type of Employee Achievement Plan Award: Qualified or Nonqualified **Yes or No**

A.. Is the award part of an established written plan that does not discriminate in favor of highly compensated employees for eligibility or benefits? _____

B. Is the average cost of qualified plan employee achievement awards presented during the year $400 or less? [1] _____

If the answer to either question A or B is "No", go to Part 2 because the employee achievement award is a nonqualified plan award. Otherwise, go to Part 3.

2. Nonqualified Plan Award **Amount**

A. Total cost to employer of all prior excludable nonqualified plan awards given to this employee during the calendar year. $ _____
If this amount is more than $400, stop here. Include the fair market value (FMV) of any current nonqualified plan award in the employee's gross income. Otherwise, proceed to Step B.

B. Cost to employer of current nonqualified plan award for this employee [2] _____

C. Total employer cost of nonqualified plan awards (A + B) _____

D. Fair market value (FMV) of the awards in Step C _____

E. Greater of the amounts in Step C or Step D _____

F. Less: Excludable nonqualified plan award for this year (400)

G. Taxable amount of current nonqualified plan award [3] $ _____

3. Qualified Plan Award

A. Total cost to employer of all prior excludable nonqualified and qualified plan awards for this employee given during the calendar year. $ _____
If the amount is more than $1,600, stop here, include the FMV of the current award in the employee's gross income. Otherwise, go to Step B.

B. Cost to employer of current qualified plan award for this employee [2] _____

C. Total employer cost of nonqualified and qualified plan awards (A + B) _____

D. Fair market value (FMV) of the awards listed in Step C _____

E. Greater of the amounts listed in Step C or Step D _____

F. Less: Excludable qualified plan award for the year (1,600)

G. Taxable amount of current qualified plan award [3] $ _____

Notes:

[1] Awards of nominal or small value (items of $50 or less per the Regulations) are disregarded in computing average cost.

[2] Not to exceed the FMV of the current employee achievement award.

[3] The taxable award is included in the employee's gross income, is reported as wages on Form W-2, and is subject to withholding and payment of employment taxes.